EXAMINING THE INSOLVENCY TOOLKIT

REPORT OF THE PUBLIC MEETINGS ON THE CANADIAN COMMERCIAL INSOLVENCY LAW SYSTEM

Dr. Janis Sarra

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RETOOLING THE COMMERCIAL INSOLVENCY LAW FRAMEWORK

Report of the Public Meetings

Janis Sarra[1]

I. INTRODUCTION

A number of important factors in insolvency restructuring proceedings have changed in recent years, including, but not limited to: the introduction of distressed debt traders; the shifting nature of secured lenders; credit bids; forbearance strategies; highly fluctuating markets for workout financing; liquidating plans; use of derivatives to hedge risk and alter incentives of some parties to the negotiations; new legislative amendments; third party liability waivers; pre-appointment monitors' reports; and an increase in the number of complex multi-jurisdictional insolvency proceedings.

It therefore seemed timely to facilitate some public policy discussions with those professionals that are most involved with the commercial insolvency system, to determine whether or not the current legislative framework is responsive to these important changes. As part of the Honourable Lloyd Houlden Award given by the Canadian Insolvency Foundation and a grant from the Annual Review of Insolvency Law, eleven public meetings were held across Canada in 2011 to discuss these issues, with a view to considering the extent to which we need to rethink or retool some of the underlying assumptions and practices of the current insolvency law system. In total, 586 people attended the meetings, including lawyers, judges, accountancy professionals, turnaround experts, financiers, scholars, government policy staff, and in one meeting, union and pension counsel.

This report summarizes the results of the discussions. Given that the large number of interested participants was a complete surprise, the task of summarizing the comments and reflecting the discussions as accurately as possible became somewhat daunting.

[1] Dr. Janis Sarra, UBC Faculty of Law and Director, Peter Wall Institute for Advanced Studies, University of British Columbia, Vancouver, Canada, Janis.sarra@pwias.ubc.ca.

However, this document reflects, as accurately as possible, the observations made by insolvency practitioners, judges, scholars and financiers across Canada, providing a basis for future public policy discussion. What the report cannot do is adequately reflect the level of goodwill and engagement that was evident at all of the meetings. There were highly animated and well informed discussions on a wide variety of topics, with very thoughtful insights into what currently works and what may need rethinking, given the rapidly changing dynamics of the market and of insolvency workouts.

The structure of the report is to summarize responses to questions posed at the meetings, clustering the views by city or region where appropriate. As promised at the outset of the process, no individual is specifically cited, so that participants could feel free to be as candid as possible.

The report does not contain any recommendations, as the public meetings identified a real need to have further public policy discussions. However, each section ends with "Initial Changes to Consider", which reflects ideas that came up in multiple meetings. These ideas might assist in forming the basis of further policy deliberations, and ultimately, recommendations to Parliament.

It is also essential to note that an important presence was not at the meetings, specifically, union leaders and their members, pensioners and employee groups. These stakeholders are directly implicated in the firm's financial distress and an integral part of commercial insolvency proceedings. It is extremely important that any further public policy discussions directly and fully integrate representative groups of such stakeholders in the deliberations about statutory amendments. It is only through debates across perspectives that we will ensure any future amendments balance the multiple interests implicated in firms' financial distress.

The report is structured as follows. Part II examines the *Companies' Creditors Arrangement Act (CCAA)*,[2] including choice of proceeding, questions of balance in restructuring processes, current challenges in sales processes, issues of long-arm legislation, the use of corporate statutes, the role of monitors and several other issues identified as important to the success of proceedings. Part III examines the *Bankruptcy and Insolvency Act (BIA),*[3] primarily the proposal provisions, including, but not limited to, the applicability of the overall framework to different sizes and types of commercial

[2] *Companies' Creditors Arrangement Act (CCAA)*, R.S.C. 1985, c. C-36, as amended.
[3] *Bankruptcy and Insolvency Act (BIA),* R.S.C. 1985, c. B-3, as amended.

debtors, the role of the proposal trustee and receivers in proposal proceedings, issues in respect of interim financing, and the effectiveness of the recent statutory amendments. Part IV offers some brief conclusions.

II. THE *COMPANIES' CREDITORS ARRANGEMENT ACT*

1. Objectives and First Principles

An overall assessment of the insolvency system in Canada requires that first principles of insolvency law be affirmed. Participants at the public meetings discussed what those principles are. Objectives of the insolvency system include maximization of the value of the debtor company's assets and thus overall enterprise value; balancing the benefits and costs of liquidation and reorganization; certainty in the treatment of claims; equitable treatment of creditors; protection of multiple stakeholder interests; and an economical, timely and efficient process. Critically important is that the court and its officers balance these objectives in their determinations under the statute.

The *CCAA* is considered essentially a commercial statute, allowing business people to solve issues relating to business financial distress. It is aimed at facilitating resolution of insolvency in a timely and cost-effective manner. The overarching goal is to provide certainty in capital markets and certainty for creditors, in turn supporting entrepreneurial activity. In recent years, the courts have also recognized the public interest aspect of insolvency restructuring. Firm financial distress affects multiple stakeholders: secured creditors, trade suppliers, employees, pensioners, landlords, customers or clients, and a host of other stakeholders with an economic interest in the company. These interests need to be considered when assessing the potential for a workout.

Notwithstanding important pronouncements by the courts in respect of balancing interests and prejudice and taking account of the public interest, there are some questions as to who is currently driving proceedings and whether it is skewing outcomes. There are also limited opportunities for input by stakeholders with fewer resources, less information and collective action problems. Collective action in a restructuring proceeding can work to achieve a better overall result, but not necessarily an individual creditor's optimal result. One practitioner at the Vancouver meeting asked whether we are currently willingly creating a restructuring system in which business people and

sophisticated market players drive a solution, to the potential harm of broader numbers of creditors and other affected stakeholders.

Canada's insolvency framework has been oriented in the past two decades towards the expectation that reorganization is almost always the better result. Legislative amendments have created additional tools to assist with restructuring, but a number of practitioners suggested that there must also be mechanisms to allow non-viable businesses to wind-down. Where they are so-named "legacy" industries, the issue is whether to offer them additional life, or whether to try to redeploy people and resources to growth sectors. Another issue identified was whether the preference for reorganization fails to allow "creative destruction", i.e. to reallocate resources to their highest and best use. Yet other participants observed that the "creative destruction of enterprises" often causes disproportionate harms, which is why courts and others are unwilling to sound the death knell of a debtor company without first assessing whether a viable business plan is possible. To suggest that resources need to be deployed to their highest use is too simple an answer; with the redeployment of resources, there are considerable externalities created, often costs borne disproportionately by those stakeholders least able to bear them.

There was broad consensus at the meetings that the nature of stakeholder participation has also changed. Distressed debt traders, unions, employees and governments are much more involved than previously. It is a court driven process, which brings with it supervision as well as the litigative aspects.

Moreover, across Canada, participants observed that there has been a degree of "Americanization" of the Canadian insolvency system, arguably harming some of the more flexible workout strategies that characterized the *CCAA* proceedings of the 1980s and 1990s. Out-of-court or informal arrangements are increasing, which raises the issue of whether this shift has led to the loss of appropriate oversight. Distressed debt traders are increasingly trying to control the process, often with a short term time horizon for realizing on their claims.[4] In previous years, a bank would be the debtor company's primary senior lender, and when a company experienced financial distress, the bank helped craft a business solution with the debtor because of its ongoing interest in the community. However, the nature of debt has shifted and the objective of preserving long term business relationships is no longer at play in a number of proceedings.

[4] Discussed in detail later in part 2 of this report.

There were a number of discussions regarding the scope of jurisdiction under the *CCAA.* For example, one issue raised was the loss of identity between economic interest and legal rights in claims, given the growth in the derivatives market. The assumption that creditors take positions that are in the interests of the general body of creditors is no longer valid. Now, interests can be bifurcated through credit default swaps. One question was whether it is equitable that a creditor that no longer has an economic interest at risk can influence the decisions of the *CCAA* proceeding in a way that affects the interests of other stakeholders.

A number of creditors now look to pre-packaged *CCAA* plans as an economically efficient move, where they conclude that the court process is uncertain given the forces at play. Such plans are crafted before filing. From a business perspective, restructuring should be able to occur both outside and within *CCAA* proceedings, including sale processes. A number of practitioners observed that codification of the sale criteria has assisted in devising timely going forward strategies. Others were concerned that asset sales outside of a formal plan of arrangement or compromise may bypass protections in the statute.

Aside from the specific issues canvassed in detail below, there are issues that arise out of the overall framework, which are deserving of some discussion. For example, are initial orders "skinny" enough, such that debtor in possession (DIP) financing lenders and others do not exert unnecessarily strict control over the debtor or the negotiations, without proper notice to creditors or sufficient time for creditors to understand the reasons for the financial distress and the full range of possible outcomes?

One concern was whether the new provisions on DIP financing are creating problems for "DRIP" financing, i.e. financing that is approved incrementally, in tranches. Participants want to ensure that the system allows for interim financing without onerous terms being insisted on by distressed debt lenders. In Halifax, participants observed that there can be considerable delay in filing for a *CCAA* proceeding while the terms of a DIP facility are negotiated, with DIP lenders wanting their own security provisions and the attendant costs of having to negotiate the DIP contract from scratch in each case.

Participants at the public meetings discussed a number of sub-questions regarding whether or not there is an imbalance in the insolvency law system, in terms of mix of risk and reward, concerned that perhaps we have not yet found the right balance of restructuring versus liquidation. There was some concern, particularly in centres outside of Toronto and Montréal, that there has been an excessive focus on large cases when

considering the efficacy of the statute. In British Columbia, the majority of *CCAA* cases have been on the smaller side of restructuring when compared with Ontario and Québec, in terms of amount of claims and size of economic activity at risk, but also in complexity of issues. Many restructurings are single industry or real estate files, and as a result, British Columbia has not seen the myriad of issues observed in the Ontario and Québec cases. Lack of complexity may create a difference between success and failure, and British Columbia insolvency practitioners observed that creditors often wish to take control early, to avoid further losses.

One observation at the Vancouver public meeting was that initial applications are being opposed in British Columbia with greater frequency, perhaps because they do not appear that complex. There, after giving notice of the initial application, the dialogue takes 1-2 days, rather than 1-2 hours elsewhere in Canada. In contrast, in Ontario, first day orders are much less contested, there is frequently little or no opposition. In British Columbia, there is often not a lot of momentum in out-of-court workouts, as one senior practitioner observed that by the time the case actually gets to court, the parties are already entrenched in their positions. Secured creditors may be experiencing creditor fatigue in their previous efforts to have offered forbearance or workout strategies prior to filing. It raises the question of how workable the process is when there is skepticism by creditors going in.

The need for an effective public policy deliberative process for the next round of legislative amendments was emphasized by many participants. As one practitioner observed in Calgary, the "previous round of amendments drew from a relatively small group" and many recommendations were "drawn from a small base of major case matters". There was considerable call for broad-based consultations across Canada, taking into account the experience of smaller and mid-market *CCAA* proceedings. Another observation was that it is important to consider US law when considering legislature reform, because US parties are likely to attorn away from Canadian courts if they become uncomfortable with the statutory language or the exercise of the court's authority. Hence, the Canadian legislative reform process should consider how proposed changes will be perceived in the US.

In terms of balancing multiple interests and the issue of paramountcy, there continues to be the outstanding question of whether the definition of claim under the *CCAA* includes environmental concerns. One practitioner queried whether the federal government can say that on exit from the *CCAA* that environmental orders no longer apply. It is really

about the scope of the federal law, not necessarily an operational conflict. Paramountcy is engaged when there are two statutes, with two provisions that have an operational conflict or where the aims of the federal statute would be frustrated by compliance with the provincial statute. There was some concern that the courts in some instances may have too broadly interpreted this latter test in their insolvency judgments.

i. Choice of Proceeding

One issue is whether the *CCAA* is the best mechanism for sale transactions or whether receivership is more appropriate in a number of cases. If the *CCAA* proceeding is filed late in the day, in terms of a debtor's financial distress, there are potentially numerous forbearance proceedings that have already been tried and failed to succeed. A primary example would be real estate proceedings in British Columbia. In some instances, there is a good underlying business. The issue is not so much legal, but rather, a growing need for business turnaround expertise. Unfortunately, the business needs resources to bring in expertise to try to find a solution. Otherwise, practitioners noted that the debtor with skinny financials cannot really make any progress, and there may be questionable value in the *CCAA* process for the stakeholders.

Another participant observed that if one compares the restructuring process in the 1980s to now, companies are not using the process unless they are absolutely forced to, since it many not generate value added. This notion was somewhat contested at the other meetings, with participants observing that there are both operational and financial issues that can be addressed, including opportunities to have more pre-packaged plans that deal with balance sheet issues or that can address a dissent on the board. One issue raised frequently at the public meetings was that management should have been undertaking a number of restructuring strategies earlier. All the things that should have been done years ago weren't done, and for real estate files, the question is why the first mortgage holder should be prejudiced for a proceeding that might not work.

Participants also observed that there may be some issues regarding freedom of contract exchanges and forbearance by creditors. Generally, practitioners reported that there has been a greater effort to tie up creditors through credit facilities. The debtor may have been given months to a year or more to find new capital or investors and still it wants a chance at restructuring. One suggestion was that perhaps the *CCAA* should be less accessible to that type of debtor; or that more weight should be given to respecting terms of contracting prior to an initial application. The prevailing view was that the debtor can't

contract out its rights under the *CCAA*, but some participants questioned whether it makes sense in terms of forbearance contracts.

Another framework issue is whether the recent use of corporate statutes such as the *Canada Business Corporations Act (CBCA)* to effect a restructuring is appropriate or desirable. These files are entirely driven by the debtor, and are sometimes used to restructure an insolvent company by creating a solvent corporation to be the applicant under the statute, much in the same way that instant trust deeds were used in the past to qualify for relief under the *CCAA*. The arrangement provisions of the *CBCA* are even more skeletal than the *CCAA* used to be, and the court can easily decide that it has authority to make orders not specifically addressed in the statute, such as ordering a stay of proceedings. There is no independent party or monitor there to look at the transaction. Opinions of value are sometimes given by people who have conflicts of interest. Moreover, the information that the court receives may be imperfect. Yet it remains one choice of proceeding under the current structure.[5]

ii. Fundamental Questions

There were a series of other fundamental questions that were raised at the public meetings as part of the first principles discussion, many of which are discussed in much greater detail later in the report. For example, can the monitor be effective and independent if it acts as adviser and facilitator in the context of the proceedings? Several practitioners raised this issue in the context of advocacy that has appeared in the pre-filing reports filed by monitors not yet appointed by the court. In a number of monitors' experience, it is possible to have this dual role if all parties understand that the monitor is a facilitator, not an advocate.

There was considerable discussion as to whether the current negotiation process under the *CCAA* fails to create a workout process in which creditors are bargaining in good faith. Some practitioners suggested, for example, that the current process under the *CCAA* allows parties to take positions that they know have low likelihood of garnering approval; but they do so as it increases their position relative to others, and given that there is no obligation to necessarily act in good faith there are no downside consequences to their behaviour. Such a strategy flies in the face of a constructive collective process.

[5] Please see discussion in part 6 below.

Another issue raised across the country was employee protection in restructuring files; specifically, whether the protection is sufficient or whether more could be done, considering that there is a limited protection for employees who have lost their employment and the court has condoned the practice of withholding payments for some employee benefits such as past service costs.

One suggestion was that special payments should be protected under the legislation and be entitled to share in a distribution in the plan. One practitioner pointed out that the actuarial calculations change every time they are done, based on the terms of the plan. Yet other participants suggested that many problems could be prevented by requiring that actuarial calculations of pension liabilities be more conservative earlier in the debtor company's financial life, to ensure that the debtor is given the full opportunity to set aside the appropriate level of funding to meet pension promises. One practitioner felt that doing a compromise of the pension deficit amount without changing the terms of the pension itself is a non-starter in terms of resolving the financial distress of the business.

Stakeholder dynamics and the alliance of voting interests are changing right across the country. One idea proposed was that proceedings have matured to the point where we can have a creditor list, and that reform efforts should concentrate on the timing, content and purpose, etc. of such a list. There have been private initiatives to have a creditors' list of record, in part to help identify the true economic interests in terms of the debtor's capital structure. Arguably, there is a lack of transparency from those creditors that can call the tune in a restructuring proceeding. However, another practitioner observed that ongoing creditor lists are difficult to maintain, giving the amount of claims trading on publicly traded companies. Others supported the idea of a creditors' list, but do not want the process to become so formalized that it moves Canada towards formal creditors' committees.

There was quite animated discussion as to, fundamentally, whether or not our restructuring processes are working. The number of *CCAA* proceedings is dropping. Accounting firm mandates across the country have very few formal restructurings, but they do have a long list of out-of-court style restructurings and receiverships.

Generally, there appears to be a trend away from the *CCAA* cases across Canada. Cases such as Nortel[6] and Abitibi[7] need access to these multi-jurisdictional tools. Yet

[6] *Re Nortel Networks Corporation*, Ontario Superior Court, File #: 09-CL-7950, Ontario Court of Appeal, File #: M38773; M38748.

most of the Canadian economy is mid-market, and frequently practitioners observed that the *CCAA* does not really work for these debtor companies. The cost of repeatedly going back to the court for advice and direction can make the cost of a proceeding prohibitive. The *CCAA* has switched from a reorganization statute to a value preservation statute, and many participants suggested that the process is costly and inaccessible for many firms, given its changing outcomes.

In terms of using a receivership within a *CCAA* proceeding, one view was that there are benefits and there is value in preserving an on-going business entity, even if everyone operating it is new, and there is not that flexibility in a receivership. A number of participants, particularly in Calgary, Vancouver and Montréal, observed that if the fundamental purpose is to preserve an on-going business, a debtor company might be better served with a different process, given how expensive *CCAA* proceedings are. The view was that if a business has access to any other option, it will often choose that process instead of the *CCAA*.

Another concern was whether businesses are waiting too long to enter the *CCAA*, making it more difficult and less likely for a successful proceeding. For example, if the debtor company has been in forbearance for over a year, it may be too late to start a restructuring process, as creditor fatigue has set in and willingness to negotiate and compromise is already at its limit.

Another fundamental issue raised at the meetings was whether or not the *CCAA* is the best vehicle for credit bids.[8] If so, there was a sense that greater protections should be built into the process to ensure its transparency and integrity. The *CCAA* may not be sufficiently responsive to the kinds of challenges debtors face today with the particular kinds of creditors that are involved.

Although one suggestion was that there could be new provincial legislation enacted to address the restructuring of small and medium enterprises (SME), generally, the view was that there would be difficulties with design of yet another system, both in respect of the federal division of powers and ability to bind creditors nationally; and in terms of what it would mean for reduced access to US credit.

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[7] *AbitibiBowater Inc.,* Québec Superior Court, File #: 500-11-036133-094.
[8] See the discussion in part 2(i) of this report.

While the *CCAA* was found to be expensive and time consuming, only a few participants thought it had uncertainty. However, there was strong support in several cities for greater flexibility in the administration charges; and to allow expanded duties of the monitor where appropriate, such as in centres where there are limited numbers of insolvency professionals, to allow directly for business consulting or to allow the monitor to engage such expertise.[9]

The fact that terms are only partially codified in the *CCAA* can work to the advantage of negotiations, as parties will bargain in the shadow of uncertainty. Experience regarding the use of the *CCAA* for mid-market firms varied across the country, as did views about whether it is helpful for the mid-market sector. There have been instances in which it has proven helpful, particularly where it can be used to bring in new management.

Participants observed the shift in proceedings from purely commercial proceedings to proceedings in which the Supreme Court of Canada has acknowledged the importance of employees and social stakeholders. There are costs associated with inclusive processes and the parties need to be mindful of that. Yet another practitioner observed that the Canadian processes that are inclusive are still considerably less expensive than the cost of unsecured creditors' committees in the US.

iii. What Constitutes "Balance" in an Insolvency Restructuring Proceeding?

Participants at the public meetings posed the question of what constitutes balance in an insolvency restructuring proceeding. One definition of balance suggested was: "a state in which various parts form a satisfying and harmonious whole and nothing is out of proportion or unduly emphasized at the expense of the rest." When the future of a business is at stake, there are always countervailing forces and one issue is whether the implicated stakeholders face the appropriate balance of risks.

One very senior insolvency practitioner observed that balance, in the insolvency context, is achieved by not doing a number of things: for example, by not providing any particular stakeholder an advantage over another; by not tilting the process in favour of any particular outcome; by not creating economic access or participation hurdles; by not discouraging out-of-court resolution; as well as by penalizing stakeholders who pursue less than legitimate propositions. However, he noted that the system may need rebalancing to ensure these basic considerations are met. Another participant observed

[9] See the discussion on the role of monitors in part 7 below.

that debtors may too easily be able to gain court protection, not so much for preserving businesses, but to entrench pre-filing managers.

In considering the appropriate balance of restructuring versus liquidation as the preferred outcome of an insolvency proceeding, it was suggested that there is a need to clarify terminology. One participant observed that reorganization or restructuring generally means that the legal entity survives. The sale of a going concern is generally not a reorganization; it may be a redeployment of assets. Arguably, insolvency restructuring should be aimed at saving the business activity, employment and trade relationships that are important to the business, not the particular legal entity. In Nortel, the business activities were being preserved, but entities were being sold to free up capital to meet creditors' claims.[10] Viable businesses are worth preserving. A number of practitioners noted that if there are to be preferences for restructuring over liquidation, it is important that we make an informed choice about the respective benefits and costs of this decision.

One issue identified across Canada was the perceived "prejudice" against a party other than the debtor commencing proceedings, even though technically speaking, the *CCAA* does not limit who can commence an initial application. One practitioner in Vancouver observed that the statute is somewhat confusing, as in some instances, it specifies "debtor," and in others refers to application by "petition".[11] The *CCAA* envisions a secured creditor filing, but does not necessarily address all the different scenarios. For example, Calgary practitioners observed that in the Bear Mountain proceeding, there were continual issues regarding the scope of proceedings.[12]

Real property has been a big issue in British Columbia in recent years. If the debtor has gone through a foreclosure process, it can still file for *CCAA* proceedings. One recommendation was that if a court supervised process has already been undertaken or completed and the debtor seeks to commence a *CCAA* proceeding, there should be greater transparency regarding the factors that the court will consider before the debtor is allowed to further forestall creditors realizing on their remedies, which in turn might create greater certainty in the process.

Courts report that they see an increasing number of liquidating *CCAA* proceedings, and while they have been approved, there was concern expressed that there is often no real

[10] *Re Nortel Networks Corporation*, Ontario Superior Court, File #: 09-CL-7950, Ontario Court of Appeal, File #: M38773; M38748.
[11] See s. 10(1), *CCAA*.
[12] *Bear Mountain Master Partnership*, British Columbia Supreme Court, File #: S102120.

plan of arrangement, no approval by the classes and the court is pressured to approve the process immediately because it is advised that there is no other going forward option. In effect, such plans can serve as a form of cram-down that bypasses many of the checks and balances of the system. The suggestion was that if liquidating *CCAA* proceedings are to continue, parties should be subject to the same standards as ordinarily required under the *CCAA.*

A number of participants in British Columbia questioned whether liquidating *CCAA* proceedings should be permitted. In Pope & Talbot, there was no plan at the end of the day.[13] Similarly, the Ted Leroy Trucking proceeding involved a court endorsement of a liquidating *CCAA*.[14] Several participants suggested having an enhanced receivership or using the *CCAA* for liquidation if it will preserve value. One view was that if the options are to keep something operating or sold off in bits and pieces, it doesn't necessarily matter which vehicle it is, as long as it is effective. However, it was felt that the *CCAA* needs to be explicit if it is to use a receiver to liquidate the business, perhaps creating statutory language where a receiver would have authority under the *CCAA* to disclaim contracts, etc. and work to maximize value.

One participant in Toronto observed that in balancing the risk, if it is a liquidation, the issue is how much money goes to prime the secured creditors and how long they have to wait. One view was that there is generally enough money to satisfy the claims of the secured creditors. However, another view was that *CCAA* proceedings can involve a siloed approach, and the courts and parties should be able to design a process that works for both secured and unsecured creditors. One practitioner observed that a liquidating *CCAA* is between the silos. The decision for most insolvency practitioners is the business case, in terms of assessing the real value of the business and how value can be added to it. It is easy if there is one lender, but that situation is increasingly a rarity. If there is more than one lender, the creditors are not all going to agree on the process. In Montréal, the view was that even with multiple lenders, there is an underlying assessment of the business case, but the *CCAA* may need explicit language addressing liquidating proceedings.

There were a number of practitioners and lenders that thought creditors have lost faith in the process; and that debtor companies, creditors, and unions are afraid of outcomes because of a shifting balance in power to short-term powerful market players. Others

[13] *Pope & Talbot Ltd.*, British Columbia Supreme Court, File #: S077839.
[14] *Ted Leroy Trucking Ltd. and 383838 B.C. Ltd.*, 2008 BCSC 1805.

suggested that the *CCAA* is helpful because there is more flexibility that either the *BIA* or out-of-court processes. In Canada, there are many owner/manager blurred lines, which make it challenging to separate interests in a restructuring. The benefit of a restructuring is maximizing the return; the problem is often existing management. It was noted that although creditors can now seek to replace directors under *CCAA* proceedings, but it is difficult.[15] However, another view was that once you are playing with other people's money, maybe it doesn't really matter about the owner/management.

Regarding *CCAA* restructurings of SME, practitioners in Calgary and Halifax observed that a big expense in smaller files is resolving the claims. If there was easy access to the court, parties could have a reasonable realization of assets, but resolving the claims is a big issue. The view was that the claims process really defeats the smaller *CCAA* files. One strategy that has worked well in Alberta in the smaller files has been for the monitor to send a notice that "this claim is the amount you are owed unless you tell us otherwise, asking the claimant to confirm and return". By creating a default mechanism, the claims process has been expedited.

Another suggestion was that the supervising *CCAA* court could authorize another judge to undertake judicial dispute resolution on certain claims, which could be quite effective in appropriate circumstances. There was consensus that this authority already exists under the statute. Depending on the case, such an appointment might be quite valuable and save costs in the process. It has been used successfully in Ontario. The difficulty, however, is the effective use of limited judicial resources and the time commitment involved in claims determination. Other forms of claims officers may be appropriate, to engage in mediation, a process of effective recommendation or binding arbitration, but costs are a consideration. Having a claims officer or a mediator is not an assurance that the cost of resolving a claim can be controlled. However, practitioners suggested that shortening the time for the process would reduce costs. There is experience in some jurisdictions that if the court has a high deference to a negotiated resolution, then the parties will take it more seriously. The courts have expressed willingness to consider processes that expedite claims determinations.

One issue was whether repudiation of agreements merely transfers value from one stakeholder to another, rather than being linked directly to the ability of the debtor company to restructure to ameliorate its financial condition.

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[15] Section 64(1), *CCAA*.

At the Vancouver meeting, there was considerable discussion regarding the frequent focus on the legal processes, which often is just protecting the existing management and not really bringing in any new talent or practical business expertise. In real estate, the regular business fundamentals don't work as the businesses are pretty unsophisticated. The big gap is the people who know the business. Several participants in Calgary and Vancouver suggested that in many cases there is, or should be, need to bring in a specialist.

The Supreme Court of Canada has ruled that fiduciary duty is not owed by the directors directly to the creditors. For some practitioners, the judgment in *Re Peoples Department Stores Ltd.*[16] raised the question of what it means to owe a duty to a corporation in an insolvency situation. One practitioner suggested that bankruptcy law should inform those duties in a positive way. The consensus in Toronto was that boards are rarely in any doubt about what their role is. They usually do what they think the right thing is, and they are cautious. In terms of governance of larger debtors or corporate groups, corporate boards are getting advice about their duties apart from their personal risk exposure. A good monitor can remedy a lot of potential for abuse. Participants' experience was that boards usually get it right or close to right. They are trying to balance interests and most of them are relatively good at such balancing. Usually, if the board is incompetent, then the monitor will take a much more active role. There is rarely one correct answer to a debtor company's financial distress. If the board has the necessary resources, it helps. In the large public company proceedings, the board has much more assistance, a chief restructuring officer (CRO), financial advisors and other professional assistance. For smaller debtors, cost is an important consideration in getting governance advice.

Where directors fail to act in the best interests of the corporation, the statute has the remedy of removal of directors, which many noted has created new incentives for directors to act appropriately. Some practitioners suggested that the Canwest case was a good test case for the removal provisions.[17]

One practitioner observed that the debate around the role of the monitor is occurring at the same time as the shifting purpose of the *CCAA* from a debtor restructuring statute to a creditor-realization statute. In her view, the *CCAA* isn't rehabilitative, it is facilitative.

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[16] *Peoples Department Stores Inc. (Trustee of) v. Wise*, 2004 SCC 68, [2004] 3 SCR 461.
[17] *Canwest Global Communications Corp.*, Ontario Superior Court, File #: CV-09-8396-00CL; *Canwest Global Publishing Inc.*, Ontario Superior Court, File #: CV-10-8533-00C; *Canwest Publishing Inc.*, Ontario Superior Court, File #: CV-10-8533-00CL.

iv. Initial Stay Orders

There were suggestions in Toronto and Montréal of creating an automatic stay in initial *CCAA* applications. The view was that it would level the playing field at the front end of the proceedings and that the process could be harmonized by statute; such as a specified date for the first hearing and day one consequences. It was observed that much of what is done by practitioners in framing a proceeding and advancing their clients' interests is how to prevent loss or gain in first day positions. One practitioner noted the debtor is going to go with what it can reasonably justify, and sometimes beyond. Participants suggested that, arguably, the gaming goes out the window if there is an automatic stay with a process for getting extraordinary relief. If the debtor company gets the automatic stay and comes back in ten days, the debtor can settle a lot of things about the case during that initial, short stay period.

Is there a downside to having an automatic stay? One question is who the monitor is on day one and what is the scope of its mandate, without there being court approval. Another question is whether creditors would be disadvantaged in any way by an automatic stay in which it might take a few days to get a hearing to set aside the stay, if they objected. Another concern was that the debtor might file without sufficient disclosure in the affidavit as to the reasons for entering *CCAA* proceedings and the necessity of a stay period, if it does not have to appear before the court to justify its application. Here, the role of the proposed monitor might be critically important.

The concern was that if the appointment of the monitor was automatic with the automatic stay, it may be difficult for creditors to challenge that appointment after a few days. One suggestion to remedy that issue is to require the debtor company to consult with senior creditors regarding choice of monitor before filing for the automatic stay.

One practitioner suggested that it makes more sense to identify what is happening on day one, in terms of any impropriety, than what is not happening. His view was that there is no strong record of parties getting in and blocking the creditor-debtor hand-in-hand plan. Others suggested that there is not much detriment to an automatic stay. It would put more pressure to shift day one matters to later, requiring a wait of five to ten days; although one issue would be how the debtor would be able to bankroll itself for the five to ten days following. One option may be very short DIP financing for ten days only, if the debtor needs it to "keep the lights on", prohibiting the types of control provisions in that early DIP facility that parties have been concerned about.

One practitioner in Montréal observed that if there was a limited or automatic stay, ten days would be too early in practical terms to address issues in a significant way. His view was that there are a deluge of creditors that have issues with the debtor, and ten days is not sufficient to address their demands. However, if the initial day order was only a "lights on" order, a 30 day period would be sufficient to sort out a number of issues.

One issue is the scope of what's being asked for in initial orders. Several participants noted that the parties were careful in the Canwest proceeding to specify to the court that it was not a plan, but what was ordered was almost impossible to change.[18] The issue is leverage and timing.

A number of participants at the public meetings suggested that given the opaqueness of certain aspects of the system, in terms of disclosure, the first day affidavit from the debtor is important, which would be lost in an automatic stay. However, others noted that a detailed affidavit could be a filing requirement, as part of the checks and balance, and a prerequisite to the automatic stay becoming effective. Automatic stays are seen as non-creditor friendly. A short form order, or expressly limiting what could be done in an initial order, could maintain a more creditor friendly status.

Presumably, a creditor should not be allowed to unilaterally place the debtor company into *CCAA* proceedings, so there would have to be no automatic stay in such instances or there would likely be problematic consequences.

Some practitioners expressed a preference for a court procedure regarding limits on first day applications rather than statutory language regarding automatic stays and limits. They expressed doubt that Parliament would be interested in statutorily embedding an automatic stay that could be misused and lead to a perception of an overly debtor friendly regime.

The concept of a short form order of the initial stay was favourably viewed across Canada. Initial orders are overwhelmingly granted, but the extensive nature of first day orders can frequently disadvantage smaller creditors and others that have not been part of the pre-filing discussions. One suggestion was that the courts limit the initial order to only urgent DIP financing and appointing the monitor.

[18] *Ibid.*

A number of practitioners voiced concern that extraordinary relief is granted much too readily. They noted that there is not a major company that has ever filed that just discovered it was insolvent that morning, and the system needs to hold the debtor company more accountable by prohibiting overreach in initial orders and allowing creditors time to examine the situation.

v. Initial Changes to Consider

1. *The next round of legislative reform should be conducted with broad consultation across Canada, and should account for the experience of smaller and mid-market CCAA proceedings.*

2. *The CCAA should articulate express principles regarding value maximization and fairness to stakeholders.*

3. *Consider implementing an automatic stay in some CCAA files, including setting appropriate criteria and protective mechanisms, with extraordinary relief being available within 5 to 10 days to "keep the lights on". Affidavit evidence by the debtor should be a filing requirement. The debtor company would be required to consult with senior creditors regarding choice of monitor before filing for the automatic stay.*

4. *Alternatively, move to very short first day orders with only the stay, appointment of monitor and "lights on" financing, with any other provisions brought later in the proceedings once creditors are given appropriate notice and disclosure.*

5. *Consider moving towards requiring a creditors' list in CCAA proceedings, with criteria developed in respect of purpose, timing and content.*

6. *Consider statutory language that would require parties to a restructuring proceeding to act in good faith in their negotiations and other activities in proceedings under the CCAA.*

7. *Consider amending the CCAA to create explicit statutory language governing liquidations within CCAA proceedings, with clearly articulated criteria as to when they are appropriate.*

8. *If liquidating CCAA proceedings are to continue, codify some basic protections for stakeholders and principles for the court to consider in determining whether to approve such processes and plans.*

9. *Consider requiring that the repudiation of contracts be more closely linked to debtor company's need to ameliorate its financial condition.*

10. *Consider whether it is appropriate to codify the role of a receiver in some CCAA proceedings, including the ability to disclaim contracts, with the exception of collective agreements, and set out the criteria for when it would be appropriate to make such an appointment, as well as the obligations and duties of a CCAA receiver.*

11. *Work with other jurisdictions to develop principles of comity and co-operation at the appellate levels of court, recognizing cross-border and corporate group proceedings.*

12. *Consider a default claims process for small and medium enterprises (SME) CCAA proceedings, whereby the monitor or a court-appointed claims officer determines the claims owing, and that amount is accepted unless the creditor objects within a specified time period.*

2. Current Challenges in Sales Processes

Asset sales are an increasingly frequent resolution to corporate financial distress. However, there are a number of challenges and complications in selling assets in many jurisdictions. Insolvency practitioners face practical issues in respect of conveying of the assets. Not all sellers may be in formal insolvency proceedings, creating challenges for how the parties and the courts allocate proceeds of the sale. For example, Nortel had 37 companies that were not part of insolvency proceedings, which operated in countries where there had been no filing.[19] One issue is how do insolvency professionals get access to, and convey, the assets. How does one determine equitable or fair allocation of the purchase price and proceeds among all of the interested parties in various jurisdictions? It also raises the challenge of designing a common sale process.

[19] *Re Nortel Networks Corporation*, Ontario Superior Court, File #: 09-CL-7950, Ontario Court of Appeal, File #: M38773; M38748.

Section 36 of the *CCAA* requires court authorization for disposition of business assets. The court may authorize the sale or disposition even if shareholder approval was not obtained. A debtor company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition. In deciding whether to grant the authorization, the court is to consider, among other factors, whether the process leading to the proposed sale or disposition was reasonable in the circumstances; whether the monitor approved the process leading to the proposed sale; whether the monitor filed with the court a report stating that in its opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy; the extent to which the creditors were consulted; the effects of the proposed sale on the creditors and other interested parties; and whether the consideration to be received for the assets is reasonable and fair, taking into account their market value. There are additional factors to be considered when the proposed sale is to a related party.[20] The Ontario Superior Court of Justice has held that section 36 of the *CCAA* does not apply to transfers contemplated by a plan as the transfers were merely steps that were required to implement the plan and to facilitate the restructuring.[21] The classic *Soundair* principles also continue to apply, even with codification under s. 36 of the *CCAA*;[22] however, the tests may need retooling to account for stalking horse and credit bids.[23]

There is no materiality component, and as such, all non-ordinary course sales need to be approved. Practitioners observed that some process issues have been resolved through a simple 'minor asset sale' section in the template *CCAA* and receivership orders. There continues to be some uncertainty as to proof required before the court is satisfied that the requirements under the *CCAA* s. 36(7) have been met. One question is whether the monitor should report on the quantum and how it is to be funded. The criteria do not specifically require that a sales process be carried out, rather just that a "process" occurs.

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[20] Section 36 (4) and (5), *CCAA.* 36 (4) Additional factors — related persons—If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that (a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and (b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition. (5) Related persons—For the purpose of subsection (4), a person who is related to the company includes (a) a director or officer of the company; (b) a person who has or has had, directly or indirectly, control in fact of the company; and (c) a person who is related to a person described in paragraph (a) or (b).

[21] *Re Canwest Global Communications Corp.* (2010), 2010 CarswellOnt 5510 (Ont. S.C.J. [Commercial List]).

[22] *Ibid.*

[23] *Royal Bank of Canada v. Soundair Corp.,* 1991 CanLII 2727 (ON CA).

One practitioner suggested that this distinction is important for cases where the secured creditor is significantly underwater, such as in the Fairmont Resort Properties.[24] There is no requirement for court approval of the sale process procedures, yet most cases seek such approval in order to create certainty and confidence in the process. DIP financing terms may be negotiated and approved well in advance of an application to approve a sales process. A number of participants at the public meetings suggested that the court and practitioners need to be mindful of DIP lending terms that may restrict the sale process, such as rights of first refusal.

Another issue raised was the concern that asset sales, without a formal *CCAA* plan, creates uncertainty as to whether the statutory requirements of a plan, such as the protection of employee priority wage and pension claims, need to be complied with, creating a mechanism for the debtor to avoid its statutory obligations. The court should not approve any asset sales outside of a plan unless it is satisfied that all the statutory provisions relating to protection of employees and other creditors have been complied with.

There are a number of issues specific to credit bids, stalking horse proceedings and valuation of offers that were discussed at the public meetings.

i. Credit Bids

A relatively recent development in financing workouts of insolvent businesses is the use of credit bidding, which has occurred in cases such as *Canwest* and *White Birch*.[25] A credit bid allows a creditor to essentially use its debt to bid for the assets of the company, often in a stalking horse process. Although there is no express language in the *CCAA* that allows credit bidding, as there is in the U.S. *Bankruptcy Code,*[26] Canadian courts have accepted credit bids as a reasonable means of financing the workout. There are a number of challenges both inside and outside of a *CCAA* plan or receivership. Canadian

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[24] *Re Fairmont Resort Properties Ltd.,* Alberta Court of Queen's Bench, File #: 0901 04199; Alberta Court of Appeal, File # 0901-0191-AC.

[25] *Re Canwest Global Communications Corp.*, (2009), 2009 CarswellOnt 6184 (Ont. S.C.J. [Commercial List]); *Re White Birch Paper Holding Co.*, 2010 CarswellQue 1780 (Que. S.C.J.).

[26] US *Bankruptcy Code*, title 11, §363(k). That section suggests that the lienholder may make an offer to protect its position, as a defensive move against a sale at under-value, although there is no requirement that the lienholder must stop making offers once the debt is covered – the lienholder is given a right to bid, subject only to restriction that may be imposed by the court, for cause. More importantly, the section suggests that the lienholder may only be able to set off its debt on the purchase price of the encumbered asset, which raises an interesting question as to what happens when the sale includes both encumbered and unencumbered assets.

practitioners and courts have looked to the US *Bankruptcy Code* for some initial guidance.

One issue is that a creditor may have access to considerable information as a result of its position as a senior secured lender. Thus, it is important to ensure that any bidding process is fair and transparent in terms of the financial and other disclosures. If the bidding creditor is also the DIP financier, it may pressure the debtor for a truncated process that does not generate a true market for bids; or it may pressure for a lower value to be attributed to the business, given that pricing is difficult to determine at the point of insolvency. Valuation of credit bids can be difficult; for example, it can be determined to be dollar for dollar of debt or based on the underlying value of the assets. The underlying value approach to the value of the credit bid has been raised in recent cases such as Brainhunter;[27] however, several practitioners at the public meetings expressed the view that the judgment in that proceeding involved an incorrect application of value when the creditor was bidding on encumbered assets.

There are also issues regarding the appropriate mix to encourage cooperation and prevent harmful collusion. If bidders collude, the bid price will be inappropriately pushed down. Financial advisory committees have a role to play in ensuring the integrity of the process, although it is difficult for such committees to serve as watchdog in complex proceedings. They are not on site and thus cannot engage in continual monitoring. The monitor may not have full access to information on the process such that it can monitor the integrity of the process.[28]

There were also concerns raised about some *CCAA* proceedings where the secured lenders are not included in the stay. In such instance, practitioners observed that, in negotiating sale process procedures, the debtor is left to negotiate with the secured creditors on an uneven playing field, raising the issue of whether such a situation is appropriate or fair. If the secured creditors want to acquire the underlying business through a credit bid, it may be in their interest to establish a sale process that is not competitive for the other parties participating.

Lenders submitting a credit bid may be doing so primarily to preserve value and stability, not necessarily because they have a strong desire to own the business. For example, participants advised that in the Canwest LP case, the lenders wanted a robust sale

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[27] *Re Brainhunter Inc.*, 2010 ONSC 1035.
[28] Please see discussion in part 2(iii) regarding confidentiality and non-disclosure agreements.

process because being "topped" and paid out in full was seen as a positive result.[29] The practice indicates that even while excluded from the stay, the secured creditors can sometimes effectively be included, basically substance over form.

There are also governance issues involving lender syndicates in respect of the ability or authority to make a credit bid and either 'drag along' or 'cash out' the non-participating or dissenting lenders. This challenge is considered to be an "inter-creditor" issue and is generally not addressed by the courts. The authority to do so in Canwest LP was achieved via a senior secured lenders' plan under the *CCAA.*[30] In such cases, there is an important role for the monitor and the court in ensuring that the process is fair, that information is available that allows competitive bids to come forward, and that any conflicts of interest are controlled as much as possible.

In the White Birch proceeding, the Québec Superior Court approved the sale of the assets of the debtors to the original prospective purchasers, which had, in part, utilized a credit bid.[31] Justice Mongeon held that if credit bidding was to take place, the amount of the credit bid should not exceed, but should be allowed to go as high as, the face value amount of the credit instrument on which the credit bidder is allowed to rely. The credit bid should not be limited to the fair market value of the corresponding encumbered assets. He held that it would be impossible to function otherwise because it would require an evaluation of encumbered assets, a difficult, complex and costly exercise. Justice Mongeon observed that once an approved bidding procedure has commenced, it should continue, absent any illegality or non-compliance or proper procedures. Here, the winning bid satisfied a number of interested parties, including the winning bidders, the monitor and several other creditors. In applying s. 36 of the *CCAA,* Mongeon J. held that all the elements of section 36 need not to be fulfilled in order to grant an order; the court should look at the transaction as a whole and decide whether or not the sale is appropriate, fair and reasonable. He held that the court can approve the process for reasons other than those mentioned in s. 36 or refuse to grant it for reasons not mentioned in s. 36. Relying on *Re Canwest Publishing Inc. /Publications Canwest Inc.* and *Re Nortel Networks Corp.*,[32] the Court held that the process in the proceedings before it met the criteria set out in those decisions; and the price to be paid by the winning bidder was satisfactory,

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[29] *Canwest Global Communications Corp.*, Ontario Superior Court, File #: CV-09-8396-00CL; *Canwest Global Publishing Inc.*, Ontario Superior Court, File #: CV-10-8533-00C; *Canwest Publishing Inc.*, Ontario Superior Court, File #: CV-10-8533-00CL.

[30] *Ibid.*

[31] *Re White Birch Paper Holding Co.* (2010), 2010 CarswellQue 10954 (Que. S.C.).

[32] *Re Canwest Publishing Inc./Publications Canwest Inc.* (2010), 68 C.B.R. (5th) 233, 2010 CarswellOnt 3509 (Ont. S.C.J. [Commercial List]); and *Re Nortel Networks Corp.* (2009), 56 C.B.R. (5th) 224, 2009 CarswellOnt 4838 (Ont. S.C.J. [Commercial List]).

given the circumstances, and the terms and conditions of the winning bid were acceptable.[33]

While credit bids may offer a helpful alternative to financing a workout, particularly in the tighter post-financial crisis credit market, their further development must be undertaken in a manner that ensures that the integrity of the restructuring proceeding is maintained.[34]

At the Vancouver meeting, the view was that credit bidding can be valuable, since sometimes there is good reason for using the *CCAA* process even if there is no expectation of a going concern work-out. This topic was viewed as having particular relevance to British Columbia since many proceedings are specific to real estate. In Calgary, one practitioner observed that credit bids are an issue, in terms of how they are run and the potential prejudice to other stakeholders. One practitioner observed that the experience in Alberta is that if a credit bid is contested, there are often real and nuanced questions of valuation. In one case, the receiver had to do a lot of homework to value the credit bid to make sure that it was comparable to other bids in the market. One view was that the valuation of credit bids should be up to the courts, but that it is incumbent on parties to place the appropriate information before the court to aid its determination.

One participant in Toronto raised the issue of whether credit bids create an imbalance in the restructuring proceedings. She suggested that it will largely depend on the speed at which parties are going to enter into these arrangements and the information available to outsiders. Stakeholders do not necessarily know the value of the company and the value of the credit bid itself, especially on larger bids where the bidder is a bond holder and it is difficult to know what its actual stake is. Others in Toronto observed that credit bids are extremely useful in the right process and can get the right results and best price if used correctly.

In terms of formulating the credit bid process under the rubric of the *CCAA*, the stakeholders, court and monitor need to ensure that the secured creditors are not using the process solely to foreclose. They need to be mindful of a situation where the credit

[33] Appeal denied, with reasons at 2010 CarswellQue 11534 (Que C.A.).

[34] For a full discussion, see Pamela Huff, Linc Rogers, Douglas Bartner and Craig Culbert, “Credit Bidding – Recent Canadian and US Themes”; Jay A. Swartz and Natasha J. MacParland, “Canwest Publishing – A Tale of Two Plans”; and Kevin McElcheran, “An Open or Shut Case? Comparing the Bidding Process and Outcomes in Canwest Media and Canwest Publishing”, in Janis Sarra, ed. *Annual Review of Insolvency Law, 2010* (Toronto: Carswell, 2011). See also Janis Sarra, *Financing Insolvency Restructurings in the Wake of the Financial Crisis: Stalking Horses, Rogue White Knights and Circling Vultures* (2010) Penn. Int’l L. Rev.

bid is not going to solicit something in excess of the secured creditor's collateral. Even if they permit the indubitable equivalent of the security, there is the potential for abuse.

Yet in many instances, credit bids are used in a defensive manner. Creditors are willing to let the sale go forward, but the creditor will bid its debt. One insolvency professional in Toronto observed that it is an acceptable shortcut to foreclosure, and there may be no need to outbid the creditor, as the insolvency professional is basically foreclosing the property to the lender. Third parties will have to pay more than the secured creditor. The insolvency professional is essentially running both processes in parallel. Another view in Toronto was that it is an unsuccessful sales process that ends up with the credit bidder getting the property.

It is possible that the credit bidder, because of its position as lender, is privy to information that is not available to other bidders, which creates an unfair playing field. The secured lender sometimes has more access to the bidding process, since it is not just inside of the data room, but also has access to week to week financial information. Such creditors can also be aware of what other bidders are bidding. Hence, the monitor's role in ensuring the integrity of the bidding process is very important.

The timeline is critical. If other bidders feel that the credit bidder has too great a head start, it will likely result in fewer bids, because they will conclude that there is insufficient time for proper due diligence and to meaningfully participate. The monitor and the court need flexibility to assess the situation.

Québec practitioners observed that credit bidding in Canada has resulted in the court developing some principles, but not rules. Under §363 US *Bankruptcy Code* rules, there must be a close connection between the unencumbered assets and the credit bids. Practitioners observed that a DIP lender may tire of the debtor company's situation, force everyone to put the assets up for sale, and credit bid for its DIP loan. Such an outcome may be unfair on both a process and substantive basis.

Another Montréal practitioner suggested that the theory of credit bidding is the creditor's ability to protect its assets. If the assets are worth more, in theory, someone will offer more. There must be a proper process in place that properly values and exposes the assets. Credit bids must be critically assessed, to minimize the risk that value is inappropriately allocated to one asset or another, and to ensure that there are not disproportionate values given to certain classes.

One Toronto insolvency practitioner observed that in the US, there is often a real battle within the class. There is an argument that the value of the credit bid should only be valued as per all of the class. It is very difficult in the US to do a partial class or a credit bid if a party only controls part of the value of the class. It makes it very difficult to have a truly fair process. She also observed that there are third party issues that make it very difficult. In between, the debtor is there, just waiting. Unless one has a full class bid, it gets very complicated and just invites more disputes.

Another issue that has arisen in Canadian *CCAA* proceedings is that if one other creditor in the class does not want to join, a credit bid is not really possible. It is also difficult where the first and second lien-holders own pieces of both and they are jockeying for position.

One practitioner suggested that parties could use some sort of single offer from a class in any situation where there are some insiders and some outsiders to establish the legality of the bid. The concern is to avoid disputes at the end of the process, since the court has the power to approve a deal that leaves secured creditors short. Another observed that it is better to encourage the lenders to put a floor on the bid and to force creditors to put their cards on the table at the start. It acts as a form of reserve bid and may encourage an active bidding process.

In terms of valuation, each credit bid situation is going to be fact specific. One option suggested was to structure it so that the value is what it would take to pay out the dissidents in the class. In some instances, the parties have created a form of "cram down" by coupling a quick sale of the entire business with a credit bid.

Participants in Toronto, Calgary and Montréal observed that in credit bids, the monitor has little status, and there is a tension between the ability of the credit bidding entities to control the process and giving the monitor and the court enough flexibility to deal with the circumstances as they develop.

Part of the valuation issue is how to compare a cash bid with a credit bid, and whether different considerations are appropriate. One participant in Toronto observed that shareholder bids or offers of cash are sometimes up against credit bids, and that the courts need to be cautious where they are being asked to determine questions about valuation as between different sets of insiders, without independent information as to how

the market values the business or the assets. It could lead to unfair prejudice to unsecured creditors if the valuation is inappropriately too low.

Another view expressed in Toronto was that it can be helpful for lenders to set a price, advising the debtor company that if it is going to sell for less than that price, the lenders will take equity to make up the difference. While not formally a credit bid, such a strategy was viewed as giving creditors another mechanism to receive the full value of their secured claim.

ii. Stalking Horse Bids

No statutory provisions exist in Canadian legislation to deal with stalking horse bids. Mr. Justice Gascon (then) of the Québec Superior Court considered the conditions under which a court should approve a stalking horse bid in the context of a *CCAA* restructuring, finding that there are four considerations in assessing whether or not a stalking horse bid should be authorized.[35]

First, Justice Gascon held that the court should consider whether there has been some control exercised at the first stage of competition to become the stalking horse bidder and to what extent. Given that the stalking horse establishes the benchmark to attract other bids, accuracy is critically important to the integrity of the whole process. Since the stalking horse bid is normally subject to a break fee, accuracy is also important as the call for overbids will have to exceed a certain margin over and above the stalking horse bid. Second, the court should consider whether there is a need for stability within a very short time frame for the debtor to continue operations and the contemplated restructuring to be successful. Since a stalking horse bid process is generally more stringent and less flexible than a traditional call-for-tender process, in the resort to such a process, time should normally be of the essence. Third, the Court held that it must consider the economic incentives for the stalking horse bidder, such as break fees, topping fees and overbid increments protection in terms of whether they are fair and reasonable in the circumstances. This factor enhances fairness to all bidders and helps to ensure that fees do not chill the market and deter other potential bidders and thus render the process inefficient.

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[35] *In the Matter of the Compromise or Arrangement of Boutique Euphoria Inc. and Lingerie Studio Inc.* (19 July 2007), Dossier no. 500-11-030746-073 (Que. S.C.).

Finally, the Court held that it would consider whether the time lines contemplated are reasonable to insure a fair process at the second stage of the competition, specifically, consideration of all interested bidders. On the facts, the Court was not convinced that sufficient efforts were made to get the best price at the stalking horse bid level and found that the monitor did not establish that the break fee and overbid increments protection of the stalking horse bidder were fair and reasonable; hence it dismissed the motion.[36]

Stalking horse processes generally have a legitimate purpose when there is a critical need for value preservation, delivering the message day one to customers, suppliers, employees and other key stakeholders that the business will carry on, and that there is an informed party that has faith in and is committed to the business. A secured creditor bid at the outset of a sale process is a "backstop" bid and can bring stability to the restructuring; it should be considered as a stalking horse bid if the four criteria listed above are met. One participant observed that if these criteria are not met, then the backstop bid is not a stalking horse bid and the court needs to consider if such a bid should be authorized and approved, as in the *Trident* case.[37]

The issue is to find the correct balance between fees and other incentives, and to find the floor for valuation in a bidding process. One issue is the amount of preference the court should allow a stalking horse bidder to be given in a second round, such that a healthy competitive process is not chilled. Several participants at the Toronto meeting echoed support for the notion that the court should be satisfied that the time lines contemplated are reasonable to ensure a fair process at the second stage of the competition. In some cases, such as the Brainhunter proceeding, there may be a management group that wants to participate in bidding. Issues in respect of management's ability to continue to manage and the potential conflict of interest are real challenges for the courts.[38]

Where a stalking horse bidder wants to bid, it should be an unconditional bid if there are no other bids. There have been a number of credit bids calling themselves stalking horses, but one has to be careful of the distinctions. If it is a proper stalking horse process, a break fee may be appropriate. If a credit bid is already sitting there, another bidder should not get several million dollars separately for entering into the bidding process. There have also been concerns about "limping horse bids", which are conditional and thus should not be entitled to break fees.

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[36] *Ibid.*
[37] *Re Trident Exploration Corp.*, 2010 ABQB 88.
[38] *Re Brainhunter Inc.*, 2010 ONSC 1035.

Each situation needs to be assessed on its own merits. For example, there could be a situation where there is a success fee for the financial advisor on a credit bid, if there have been particular challenges locating any bidders over a prolonged period of time. What is important is to establish a sound process that is fair and reasonable. What seems to be missing from the criteria are the stalking horse "bid conditions", such as, is the bid truly a stalking horse bid if there are material conditions such as financing contained in the bid? There has been considerable focus on financing conditions in particular, and the board and the monitor can play a key role in deciding and opining, respectively, on the relative risk of the conditions not being satisfied. One participant observed that in the *Canwest LP* proceeding, the stalking horse credit bid was conditional on the senior secured lenders' *CCAA* plan being approved within 21 days.[39] The board and prospective monitor conducted an assessment of the benefits of the stalking horse bid versus the risk of the plan being voted down, and implications of such a result, before deciding to support the bid.

Stalking horse bids are used in fragile situations, and they can inspire confidence among customers and stakeholders. Sometimes they are creditors, sometimes they have been negotiating a deal all along. One Toronto practitioner observed that the court should only value the credit bid based on how much of the remaining part of the debt would get paid off, and that it can be a difficult problem for valuing part of a class.

In terms of the larger corporate files, a frequent observation was that they seem to be significantly influenced by the tendencies in the US, which is to restructure through sales of assets. Under the US statutory provisions, one practitioner observed that the art of success is to find the fulcrum security and sell the assets to distribute value to the higher ranking security holders and to the ordinary trade creditors through an assumption of debt, bypassing the second ranking fund providers. Another observed that the process can create an imbalance between creditors who are essentially of the same rank, by treating the trade creditors as an assumed debt or an assigned contract, while the fund providers whose security is underwater are unpaid.

A sale process can remove the decision making process from the creditors, by putting them in front of a *fait accompli.* A number of practitioners suggested that the result is correct if the sale process yields a fair market value. However, in an insolvency situation, the concept of fair market value is illusory, as at least one of the key conditions, namely that the vendor is not compelled to sell, is not achieved. Given the constraints of an

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[39] *Canwest LP, supra,* note 32.

insolvency engagement, there need to be mechanisms to assess whether the sale process yields the better result, especially if some of the stakeholders became creditors strategically with a loan-to-own objective.

Québec practitioners also observed that in dealing with acquisition strategies, one must look at the possible outcomes when a creditor wants to acquire the debtor's business through a credit bid. Unless the creditor has security that encumbers all of the assets, there is a potential for leveraging, such that the credit bid is used to acquire non-encumbered assets. The risk of inequitable results can increase in situations where the lenders effectively control the entire process, either through restrictions imposed in the interim financing agreements, or if they become the stalking horse bidder. The stalking horse bidder has an advantage over the other prospective purchasers, and that is normal, but the conditions built into the stalking horse offer should not become a bar to achieving a better offer.

One must look at the purpose of the stalking horse bid it, and creditors need to make sure that there is a buyer at the end of the day. The employees may need comfort that someone will be there, and thus, it may make sense in that situation to have a stalking horse bid.

In both Montréal and Toronto, the observation was that parties only resort to stalking horse processes when there are time pressures or other reasons that the debtor cannot run a proper sale process. In the US §363 cases, US lawyers complain that they end up in very expensive valuation hearings, when in most cases it is unnecessary because it is followed by a sales process where the market speaks. The priority should be a properly supervised sale process.

Québec practitioners observed that in the White Birch proceedings, the stalking horse turned into a "Trojan horse".[40] Yet practitioners from Montréal observed that now the system is built with that experience, and the outcome of the credit bidding process is pre-determined because of the value of the assets and security.

One issue in the credit bid process is that the stalking horse bidder is perceived to have more information than the other bidders. The monitor has to make sure that the information room is populated enough, especially if the credit bidder is part of the original

[40] *White Birch Paper Holding Company*, Québec Superior Court, File #: 500-11-038474-108, Québec Court of Appeal, File #: 500-09-021082-102; 500-11-038474-108.

owner team. A number of practitioners suggested that the court should place an onus on the monitor to comment on the sufficiency of information for the other bidders.

iii. Confidentiality and Non-disclosure Agreements (C&NDA)

There may be a lack of information flowing about the propriety of certain actions if parties are restricted from communicating because of a confidentiality and non-disclosure agreements (C&NDA). It was suggested that perhaps a standard or template confidentiality agreement is required so that parties cannot game this issue.

There is also the issue of the participation of the secured creditors in the *CCAA* sale process when they have indicated that they are bidding as a 'protective bid'. Monitors prefer that the secured creditors enter into C&NDA that specifically state that the secured creditor's bid will not be increased from the total value of the secured debt plus all priority claims. By executing the C&NDA, the secured creditors have more access to sale process information. One policy issue is whether this access to information is fair to the overall sale process. One Toronto participant observed that when dealing with liquidating *CCAA* proceedings, this issue is not as prevalent, as it is akin as to how secured creditors are treated under a receivership.

The objective of confidentiality and non-disclosure agreements should be to ensure reasonable precautions, but at the same time, to ensure that the market is not artificially restricted. There is no standardization of C&NDA; they are tailored to each sale process. The challenge is that the C&NDA can be "gamed" by the debtor company, especially if the debtor wants to exclude certain bidders from the process, or delay bidders such that they have difficulty entering the process. For example, in one recent case, a canvass of a potential 20% equity investor was flawed in that the C&NDA provided that the potential investor could not talk to Goldman Sachs; the result was that the bondholders were able to limit the interest in that investment so that their 80% looked reasonable. The C&NDA in that case was not brought to the court for approval. It can be difficult for the monitor to weigh in on negotiating C&NDA, given that it is the debtor's information. Several practitioners suggested there should be a template C&NDA that is approved as part of the sale process order.

iv. Valuation and Sale Proceeds Allocation - Methodology

One important issue in sale processes is the need to consider valuation and sale proceeds allocation at the outset of the process, in terms of both the approach and the methodology, particularly if the sale process proposes to sell both encumbered and unencumbered assets as a package.[41] In *Cow Harbour Construction,* the Court authorized a 'global' sale process that included encumbered assets; however, the encumbrances were held separately and not subject to inter-creditor agreements (leases, GSA and PMSI).[42] In *Cow Harbour Construction*, the additional challenge that occurred was that some true lease security holders wanted to take their security out of the global sale process, although ultimately, a global deal was reached.[43] This potential action by the secured lenders raised the question as to whether the secured lenders in a *CCAA* sale process need to bid or would they be allowed to watch the sale process unfold and if they didn't like the result, attempt to exclude and repossess their security. In such instances, statutory language may be required to say that secured creditors will be bound.

Participants at the Montréal meeting observed that the *White Birch* case in Québec effectively adopted a US *Bankruptcy Code* § 363 approach when the debtor sold encumbered and unencumbered assets.[44] The debtor/seller determined the minimum amount of cash that needed to be included and attributed to the unencumbered assets, and, once that threshold was met, the credit bid was allowed dollar for dollar credit. The minimum amount of cash was established using valuation methods of forced liquidation value, net book value and estimated market value.[45]

Sales and credit bids in the secondary market for debt place responsibility for value decisions regarding the value of the business in the hand of market participants. Yet several participants in Halifax and Toronto posed the question of whether favouring maintaining the debtor company as a going concern regardless of value can subvert responsibility for realistic valuations. They suggested that it is an issue that should be addressed through statutory or policy amendment.

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[41] Examples include *Cow Harbour Construction Ltd.* and *White Birch.*
[42] *Cow Harbour Construction Ltd.*, Alberta Court of Queen's Bench, File #: 1003 11241; 1003 05560.
[43] *Ibid.*
[44] *White Birch Paper Holding Company (Arrangement relatif à)*, 2010 QCCS 4915.
[45] In the US process, secured creditors were bound.

There is also the issue of the role of the monitor or receiver in terms of valuation. If the insolvency professional does not believe that the debtor or its advisors have properly valued the assets, what principles should be applied in terms of the court's deference to the views of the insolvency professional? The process of the evaluation should be fair and reasonable; and there should perhaps also be a substantive inquiry into the fairness and reasonableness. These issues may be generated in part because of a valuation process undertaken quickly where there is really no market for the valuation. These issues became particularly significant during the financial crisis, when there was little or no market for assets. In some cases, the monitor or receiver could suggest waiting six months and redoing the process. However, in other instances, when the market was unlikely to improve, it was difficult for the insolvency professional to say it would not accept the valuation, as it was unclear where the bottom of the market would settle. If the process is reasonable, one issue is whether that fact would be sufficient to accept a valuation that appears too low. On balance, it may make more sense to hold than sell. In *CCAA* proceedings, the board of directors is often still in place, or if not, a chief restructuring officer; and they may have important information about the appropriate value of the assets or what an appropriate floor value might be, on which a bidding process can be fashioned.

Unconditional bids may also be problematic for significantly sized firms. Parties usually need a regulatory-out; and many debtor companies need licenses or other regulatory approvals. If there are a number of these requirements, there may be a need to adjust the valuation floor or the size of the fees. For example, if the chance of approval of licensing is not high, it may have to be reflected in the fees. One approach is to carefully specify what it is that is being sold, for example, lien rights where there are multiple vendors or bundled assets, and to specify whether the overall value maximizing approach for creditors is to sell the entity or assets as a whole.

v. Cross-Border Challenges in Sales Procedures

Canadian insolvency statutes have no codified provisions for credit bid procedures similar to §363 (k) of the US *Bankruptcy Code*; stalking horse bid procedures; or the indubitable equivalent provision for a sale within a plan.[46] Most participants at the public meeting suggested that the flexibility of Canadian insolvency law remains attractive and further codification should be limited. One difference that needs some consideration is that in a § 363 auction process, the secured creditor must participate in the auction if it wishes to

[46] US *Bankruptcy Code*, title 11, section §1129 (b)(2)(A), a sale process in a plan.

protect its position, but in Canada, that issue is unclear and is left to what is written in the actual sale process procedures. In early Canadian cases, parties ran a process and sought court endorsement *ex post.* Now the debtor or monitor goes to the court for approval of the process; and one result is that it can accelerate many issues in the process. Generally, practitioners observed that inter-creditor issues should not spill into the court.

If there is a monitor appointed during a credit bid, creditors, particularly US based, want constant updates on who is in the information room, and they often try to extract a lot of conditions in the confidentiality agreement. There is an issue of creditors actively listening to all information and changes and saying they will not use/abuse this access to information, but the controls are unclear. There should perhaps be limits on access; for example, if a creditor credit bids, should its access to other bids be restricted, or if not, should its ability to act on that information be restricted? One approach is to say that if the credit bid is not subject to further amendment, i.e. it cannot be improved at a later date, access to other bids, on a confidential basis, would ordinarily be appropriate.

There is also an issue of overreaching sealing orders in cross-border proceedings, creating some gaming regarding confidentiality orders. Several practitioners in Toronto and Montréal argued that sealing orders should be an exception, not a means of favouring inside creditors over other potential bidders. One consequence of failing to be fair and accurate may be that information is unsealed and changes made transparent. The courts must determine the public interest engaged in the scope and content of any sealing order; specifically, considering who is likely to be harmed on approval or lack of approval of a sealing order.

vi. Initial Changes to Consider

1. *Consider developing a framework for access to information to ensure a level playing field for credit bidding.*

2. *The court should consider placing limits on access to information if a creditor is involved in a credit bid, or if not, consider restricting its ability to act on that information.*

3. *The monitor should comment on the sufficiency of information for bidders other than the stalking horse bidder.*

4. *Consider developing a standard or template confidentiality and non-disclosure agreement that clearly sets out rights and obligations, which must be approved by the court as part of the sale process order.*

5. *There should be greater clarification of the proof that needs to be brought before the court to satisfy the requirements under CCAA s. 36(7).*

6. *There should be greater clarity as to what factors should be considered in determining whether the economic incentives for the stalking horse bidder, in terms of break fee, topping fee and overbid increments protection, are fair and reasonable.*

7. *The court should assess whether or not the timelines contemplated in a sale process are reasonable to ensure a fair process at the second stage of the competition, namely, to become the successful over bidder.*

8. *The professional associations should try to clarify, for the courts, what criteria or conditions stalking horse bids should be assessed by.*

9. *The court should not approve any asset sales outside of a plan unless it is satisfied that all the statutory provisions relating to protection of employees and other creditors have been complied with.*

10. *There needs to be greater clarity in cross-border proceedings, in terms of how insolvency professionals get access to, and convey, the assets; and how one can determine equitable or fair allocation of the purchase price and proceeds among all of the interested parties and jurisdictions.*

11. *In terms of valuation of the debtor or its assets, the courts need to develop basic principles to be applied to such valuations. For example, if the process is reasonable, is that fact sufficient to accept a valuation that appears too low, but which is uncertain given that there is no active market? Second, should the monitor's opinion be given defence where it does not agree with the valuation set by the debtor and its advisors?*

12. *There should be discussion as to whether uncontested sale processes could be dealt with in an over-the-counter motion, eliminating unnecessary costs.*

3. The Challenge of Long-Arm Legislation in Multijurisdictional Proceedings

Another issue regarding jurisdiction is whether or not one must accept that orders seeking to enforce long-arm legislation from other jurisdictions can force Canadian debtor companies to assume the obligations. Does the long-arm legislation create a right to participate in the distribution of value that would otherwise be available solely to domestic creditors?

"Long-arm legislation" is legislation of another country that, by its statutory language, creates a liability against a Canadian company situated in Canada. Essentially, the statutory language utilizes "drawing aside of the corporate veil" concepts. There are two notable examples of such statutory provisions that have arisen in Canadian insolvency proceedings, pension legislation from the UK and the US; and examples of recent cases where long-arm legislation issues have arisen include *Sea Containers*[47] and *Nortel.*[48]

In the United Kingdom (UK), the *Pensions Act 2004* specifies that the UK Pensions Regulator may impose financial obligations for pension liabilities on entities associated with or connected with employees. The UK Pensions Regulator is the body charged with the enforcement of certain provisions of the UK *Pensions Act*. The regulator only needs to show that the companies are associated or related and that it is "reasonable" to issue a financial direction based on the relationship between entities.

It issues financial support directions ("FSD") that then create a liability for the Canadian debtor company for pension arrears outstanding in the UK for related entities of the Canadian debtor company. A warning notice sets out the grounds for the potential issuance of an FSD, which is a direction requiring a party to put financial supports in place for an underfunded pension scheme. Any company that is an associate of, or is otherwise connected with, an employer may be issued an FSD. In *Nortel*, the liability that the debtor companies were potentially faced with was is $3 billion.[49] Moreover, there is the cost, complexity and risk of dealing with a foreign proceeding. For example, to go to the UK to challenge a warning notice of a support direction could result in an attornment to that court regarding the disposition of assets in the Canadian entities.

[47] *In Re: Sea Containers Ltd.*, 2008 Bankr. LEXIS 2363, Chapter 11 Case No. 06-11156 (KJC).
[48] *Nortel Networks Corporation (Re)*, Ontario Superior Court, File #: 09-CL-7950, Ontario Court of Appeal, File #: M38773; M38748.
[49] *Ibid.*

In *Nortel,* the Ontario Superior Court of Justice held that service on *CCAA* debtor companies in Canada, of a warning notice issued under UK legislation was a step in a proceeding that constituted a breach of the initial stay order.[50] The monitor brought a motion for an order to declare that the purported exercise of rights and the commencement of proceedings against the applicant Canadian debtors by the UK Pensions Regulator amounted to breaches of the stay provisions under the initial *CCAA* order. The Pensions Regulator issued a warning notice to the administrators of the debtor's UK entity's pension plan as well as the Canadian debtor entities, a mandatory step towards issuing a financial support direction. The notice sent to the debtors in Canada informed them that they had until a specified date to make submissions under the UK statute, failing which default proceedings would be taken. Justice Morawetz of the Ontario Superior Court held that the stay provisions under the *CCAA* have been broadly interpreted to cover both judicial and extra-judicial proceedings that could prejudice an eventual arrangement. However, he also held that the UK warning notice clearly put the applicant debtors and the monitor on notice that there was a substantial claim that was being considered in the *CCAA* proceedings.

In the *Nortel* judgment, the Court held that the claim from the UK was a contingent claim in the *CCAA* proceedings and the issuance of the notice was another step on the road to crystallizing the contingent claim. The Court held that the notice, naming the debtors, affected the entities that were clearly within the jurisdiction of the *CCAA* court. Justice Morawetz was of the view that the UK Pensions Regulator was a person "affected" by the initial order, with which it must comply when it takes any proceedings in Canada. Accordingly, the purported exercise of rights by the UK Pensions Regulator amounted to a breach of the stay order, and for the purposes of the *CCAA* proceedings, the actions taken by the Pensions Regulator were to be given no force or effect in the *CCAA* proceeding.[51]

The judgment was challenged at two appellate courts. The Supreme Court of Canada dismissed an appeal from this judgment;[52] however, issues remain. The claims were part of a strategy by UK government entities to recoup some of the costs of their pension guarantee system, along with some tax implications. With Canada being the only country

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[50] *Re Nortel Networks Corp.* (2010), 2010 CarswellOnt 1597 (Ont. S.C.J. [Commercial List]); affirmed (2010), 2010 CarswellOnt 4112 (Ont. C.A.). The Supreme Court of Canada dismissed the leave application of the U.K. Pension Regulator in the Nortel Networks *CCAA* proceedings: *Re Nortel Networks Corp.* (2010), 83 C.C.P.B. 52, 67 C.B.R. (5th) 21, 2010 CarswellOnt 4112 (Ont. C.A.), affirming (2010), 2010 CarswellOnt 1597, 65 C.B.R. (5th) 231 (Ont. S.C.J. [Commercial List]).

[51] *Ibid.*

[52] *U.K. Pensions Regulator v. Nortel Networks Corporation, et al.,* 33 846 SCJ.

of the three with *Nortel* insolvency proceedings not to have extra-territorial legislation, there was an imbalance in the workout dynamics.[53] There was a race for the assets and at risk was potentially a reduction in return to Canadian pensioners of up to 50%.

The United States has similar legislation under its *Employee Retirement Income Securities Act* (*ERISA)*, which specifies that every member of a control group is jointly and severally liable for pension liabilities. A lien arises in favour of the Pension Benefits Guarantee Corporation (PBGC). The issue arose in the Ivaco[54] proceedings and in the Kaiser Aluminum[55] proceedings, whereby the PBGC tried to draw aside the corporate veil; and parties had to do a defensive filing to avoid the effect of the order. To date, the courts have essentially had a presumption against extra-territoriality; however, the issues are far from settled.

Given that Canada does not have similar long-arm provisions in its pension legislation, over the long term, the implications of this gap in legislation for Canada are not known. There are challenges for the parties, the courts and for legislators, and long-arm provisions are likely to be a significant issue for the next ten years, as they can create liability against Canadian debtors that pierces the corporate veil.

Moreover, outstanding issues regarding pension claims across borders could delay workout proceedings. Pension guarantee funds may be unwilling to compromise their claims in a restructuring process because of the optics for the taxpayers of the foreign jurisdiction, for example, the UK or the US government having to pick up pension fund deficiency costs, absent pursuing such claims in Canada.

Canadian recognition of foreign awards may not be sufficient to deal with these issues. If claims are not defended during the hearings in the foreign jurisdiction, one issue is whether parties can then realistically protest in Canada. At the public meetings in Calgary and Toronto, some practitioners suggested that Canada may need legislation to specify that claims from long-arm legislation, unless based on claims in Canada, are not enforceable in Canada. Another practitioner suggested importing s. 164 of the Canadian

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[53] *Re Nortel Networks Corporation*, Ontario Superior Court, File #: 09-CL-7950, Ontario Court of Appeal, File #: M38773; M38748.
[54] *Re Ivaco Inc.*, Ontario Superior Court, File #: 03-CL-5145, Ontario Court of Appeal, File #: M35582; C47542.
[55] *In re: Kaiser Aluminum Corporation*, 2006 Bankr. LEXIS 3945, Chapter 11 Case No. 02-10429 (JKF); *In re: Kaiser Aluminum Corporation*, 2004 Bankr. LEXIS 33, 42 Bankr. Ct. Dec. (LRP) 115.

Winding Up and Restructuring Act (*WURA),* specifically that if a party is holding assets in trust for benefits of policyholders, it can keep the claim and no money.[56]

Even if Canada had its own version of long-arm legislation, the reality is that the US would be likely unwilling to send assets or their liquidated value to Canada to satisfy orders to retrieve assets from the US to satisfy outstanding pension arrears. In cross-border cases, cooperation is extensive in terms of trying to realize assets, but there is not a principled framework for how they are divided and there is considerable potential for conflicts of laws and of interests. In such instances, territoriality tends to takes over, in order to protect domestic constituents. Courts can conclude that it is a matter of public policy, but they may come to conflicting results.

Most Canadian pension policies and statutes are under provincial jurisdiction, and thus it is harder to enact long-arm legislation on a national basis with extra-territorial reach. Canada does, however, have the concept of multiple employers and successor rights, but not usually in pension legislation; thus, participants suggested that it is not a large stretch to consider such legislation as an option.

There are two aspects to consider with respect to pension claims and asset sales in cross-border cases. Where foreign assets are immovable, parties have to deal with the processes and court in that jurisdiction. Where there are pre-packaged arrangements, the court may not be required, depending on the regime. The notion of a world-wide pre-packaged plan is possible but incredibly challenging. Multinational enterprises face issues of transfer pricing and cash alignment where there is a downstream proceeding. One concern is that a Canadian entity would be liable for obligations of sister subsidiaries or of any downstream subsidiary.[57] Toronto practitioners observed that trying to fund the impact of an *ERISA* claim is now driving the cost of some restructuring proceedings in Canada. Creditors are uncertain as to whether to take on and engage with the PBGF; or try to restructure in Canada to set aside the *ERISA* claim. The view was that no one really has the ability to deliver on a representation and warranty claim; yet these issues are playing out in the market.

Court to court cooperation at the appellate level in respect of long-arm claims is unlikely, and thus realistic options are needed. If there are different outcomes in appellate judgments, parties are likely to negotiate a deal. If there is a Canadian solution that says

[56] *Winding Up and Restructuring Act*, R.S.C. 1985, c. W-11.
[57] The whole idea of reciprocal endorsement of assets; whether we go back and assess revenue, if it is anything other than a claim of a direct beneficiary (i.e. not the fund or regulator).

regulators cannot enforce these claims against the Canadian debtor entities, it could provide direction; and if assets are located in the UK, it may create some leverage to come to a negotiated solution. Participants at the public meetings suggested that it is the attornment risk that is problematic; if a party thinks there is a defence, there is considerable uncertainty as to the risks if it appears. One practitioner observed that the likelihood is not; but if the party does not show up and another party gets an extra-territorial order, that order can be a problem. One view was that judgments are not going to be enforced unless culpability is found, and this approach could ring fence the problem. However, others suggested that there is the risk of courts going the other way. Pensions and trustees are almost always part of the challenge of finding an appropriate plan of arrangement where there are outstanding pension arrears; that challenge is exacerbated when the arrears are not those of the Canadian debtor entity.

Frequently, pensions are negotiated with the parent company offering guarantees. The problem of pension liability is amplified when the directors are common throughout the corporate group. In such cases, parties may sue directors for failure to meet pension obligations if there is any chance they can get at the indemnity. The problem can be skewed filing incentives because of attornment fears, which may mean that parties do not get the operational restructuring needed. There is a fear of loss of control or uncertainty. Yet some participants observed that parties often bargain in the shadow of such uncertainty. Nortel did not involve the same directors; and the directors gave a no action covenant as part of the cooperation.[58]

The issue of long-arm pension claims appear to have affected proceedings in Ontario and Québec more than other provincial jurisdictions. In the *White Birch* proceedings, one practitioner reported that similar claims were made, even though the corporate connection was remote. In several public meetings it was suggested that pension issues should be left to provincial legislation and authorities and should not be resolved through insolvency law. There was considerable concern expressed regarding the imbalance of Canadian and US pension legislation, whereby Canadian claimants do not have the same ability to seek payment of claims where related US debtors have the assets to meet such claims. Participants also noted the litigious nature of US parties, resulting in a risk that US pension authorities could become quite aggressive in their pursuit of Canadian assets to meet US pension deficiencies. One practitioner observed that it

[58] *Nortel Networks Corporation, supra*, note 19.

happened in the Circuit City proceedings; the unsecured creditors committee served notices of potential claims to avoid potential statutes of limitations.[59]

Long-arm legislation issues have the potential to alter *CCAA* proceedings not just on pension issues. The likely areas of litigation are pension issues, but there may be other areas, such as environmental law, where similar long-arm legislation may directly impact insolvency workouts. Other examples include issues in *Muscletech* regarding US tort class actions;[60] and in Nortel,[61] where approximately 18,000 French employees filed "piercing corporate veil" claims in an effort to increase their recovery, first under their own domestic priorities and then in the process to divide the global assets. The long-arm issues could potentially set back progress that has been made over the past decade in terms of comity and cooperation under the UNCITRAL Model Law.

A number of practitioners suggested that perhaps we should enact our own system of long-arm type legislation to ensure we are able to participate in foreign distributions in order to re-establish some equilibrium.

One practitioner suggested that it is acceptable that different jurisdictions have different rules; the problem is when a party seeks to attach Canadian assets to the UK rules. He observed that it would be helpful for Canadian judges to have shields that they could resort to, but the difficulty is to create a shield that doesn't have unintended consequences, such as negatively affecting how Canadian creditors get treated in foreign jurisdictions.

i. Initial Changes to Consider

1. *Enact express statutory language that specifies that foreign claims under long-arm legislation are stayed under the CCAA stay order.*

2. *Consider enacting legislation to specify that claims from foreign long-arm legislation, unless based on claims in Canada, are not enforceable in Canada, or consider other policy changes to serve as a shield to protect against such legislation.*

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[59] *Re Intertan Canada Ltd.,* Ontario Superior Court, File #: 08-CL-7841.See also *In re Circuit City Stores, Inc.*, Chapter 11 Case No. 08-35653.
[60] *Re Muscletech Research and Development Inc.*, Ontario Superior Court, File #: 06-CL-6241, Ontario Court of Appeal, File #: M34242; C46020.
[61] *Nortel Networks Corporation, supra*, note 19.

3. *Consider adopting long-arm pension legislation to be able to allow pension claimants and pension regulators to pursue claims for assets against related entities in foreign jurisdictions to satisfy outstanding pension deficiencies, carefully considering the circumstances under which such a "reach" would be appropriate.*

4. *Engage in a study of other potential long-arm legislation such as environmental remediation legislation and determine the potential impact on CCAA proceedings.*

4. Multijurisdictional Court Decisions

Canadian courts have played a pivotal role in the successful restructuring of Canadian corporations under the *CCAA,* including oversight of complex cross-border cases involving multiple jurisdictions. Even prior to the most recent round of amendments, which largely codified the jurisprudence and adopted much of the UNCITRAL Model Law on Cross-border Insolvency, the courts adopted a purposive interpretation of the statute, which facilitated viable business plans where appropriate, while working to protect the public interest and multiple stakeholder interests.

When parties are before a judge with both practical commercial experience and a strong understanding of public policy, there is considerable predictability, and parties are able to effect a good plan even in some instances where distressed debt players are trying to derail the process. However, participants at the public meetings right across Canada observed that given some of the recent behaviour of distressed debt traders, it is important to have court supervision as a temper on conduct that runs counter to the objectives of the *CCAA.* With the increase in the complexity of the cases, the shifting nature of parties to proceedings, and the frequency of cross-border proceedings, there are some new issues facing the courts.

Both in Canada and globally, the cost of court proceedings in respect of insolvency workouts is growing considerably, particularly in the cross-border context. However, there is a lack of information about the cost of proceedings and whether debtors' assets could be better deployed in other ways. Numerous participants suggested that greater transparency of costs is required so that parties can make better judgments about court versus out-of-court settlement of claims.

At several meetings, there was a suggestion that Canadian courts, practitioners and parties need to develop a better understanding of what it means to be a foreign main proceeding or non-main proceeding, and that current practice does not always align with the statutory language in the *CCAA*. For example, one observation was that "concurrent proceedings" in Canada can mean that a proceeding in Canada that has been recognized as a non-main proceeding in another jurisdiction can still be treated as a full proceeding in Canada.

There was concern expressed at several public meetings that Canadian courts have sometimes been too quick to cede jurisdiction by endorsing the centre of main interest (COMI) of Canadian entities to be in the United States. While the senior parties may push the courts in that direction, a number of practitioners were concerned that smaller Canadian creditors were not involved in the decision to treat Canadian entities as part of a US corporate group; nor are they given sufficient notice of such motions. Usually, in such instances, a "come-back" motion is ineffective because of the speed with which any potential Canadian proceedings are lost to the US proceeding.

One participant observed that if US subsidiaries are brought under a Canadian process, the subsidiary is brought in for protection, and the issue is whether there should be a separate plenary case in Canada to protect the collective bargaining and smaller creditors. The question is whether it is appropriate for them to be bundled in a COMI analysis, or better to have a separate proceeding.

The balance might be determined in the interests that need to be protected. If there is material employment or material employee claims, perhaps there should always be a material filing. One significant issue raised at all the meetings was that when Canadian enterprises are bundled into Chapter 11 cases in the US, there is concern as to whether there are substantially similar outcomes for creditors as would occur in a Canadian proceeding. One practitioner noted that in the *Lear*[62] and *Dura*[63] proceedings, the Canadian creditors were treated differently; there was not a plenary case in Canada.

Alternatively, a pragmatic approach of one US filing may be appropriate. In *Collins & Aikman*, the debtors had a blended and completely integrated cash management system.

[62] *In re Lear Corp.*, Chapter 11, Case No. 09-14326 (ALG); *Lear Canada (Re)*, 2009 CanLII 37931 (ON SC).
[63] *In re Dura Automotive Systems Inc.*, Chapter 11, Case No. 06-11202 (KJC); *Re Dura Automotive Systems (Canada) Ltd.*, Ontario Superior Court, File #: 09-8434-00CL.

Every day there was value going across the border in the form of tangible goods and cash.[64] In such cases, under a COMI analysis, the issue is whether to do an integrated filing on one side of the border, or have two plenary cases. Practitioners observed that one of the divisions ended up with a chief restructuring officer for three years. They had full cases in both places, necessary to keep the business going.

Flexibility in proceedings is to be encouraged. A significant problem, however, is procedural differences rather than substantive differences in outcome of Canadian and foreign proceedings, the vast majority of Canadian cross-border proceedings being with the US. A Toronto practitioner observed that parties are daring to break the rules in one country and test the tolerance of it in another jurisdiction. His example was that US counsel will take advantage of not giving as much notice as technically required to give; and then constantly ask Canadian counsel to break the rules.

Others observed that in large US cases with distinct Canadian assets, there is often potential for the US to just roll right over Canadian parties. The US proceedings constrain the ability for a later Canadian filing to be full and independent. The Canadian *CCAA* court does not have exclusive power over timing and control of the case where the proceedings are cross-border proceedings, even where there is court to court cooperation.

Finally, there was considerable concern expressed that the current legislation still does not address corporate groups, and thus the process or procedures when such entities come before the court are driven by the most sophisticated parties, because the court has no other option placed before it. The strategy for the particular corporate groups can be highly prejudicial to Canadian unsecured creditors, yet the court is not necessarily given the information to appropriately balance interests.

i. Protocols

Joint hearings often work between Canadian and US courts under a cross-border protocol. In part, it is because of the similarities in their workout frameworks. Canadian *CCAA* courts and US bankruptcy courts tend to have good protocol systems that parties have agreed to; and the judges are comfortable with one another. However, multijurisdictional filings are more complicated, and the legal systems and insolvency frameworks can vary considerably. There are tensions between countries that have civil

[64] *In re: Collins & Aikman Corporation*, Chapter 11 Case No. 05-55927 (SWR); *Re Collins & Aikman Automotive Canada Inc.*, 2007 CanLII 45908 (ON SC).

law court systems and those with common law systems, due to substantial differences in approach to the proceedings. Unlike Québec, with its hybrid civil law and common law system, in which the courts have found the same degree of authority and discretion under the *CCAA* as other Canadian courts, many civil law countries expressly prohibit court to court communication or mechanisms not set out in their governing statute, which can affect choice of forum and cross-border cooperation.

One highly contested issue at the meetings was whether in some instances there has been an over-reliance on the courts to deal with multijurisdictional disputes. One view suggested that participants are replacing sound business decisions with too frequent court approval of actions; and that, as a consequence, there is no disincentive for stakeholders, including the debtor and creditors, to advance outrageous propositions with little or no consequence for their actions. An even more contested view was that there is increasing risk of the court becoming an active participant rather than the arbiter, resulting in potential for loss of integrity or independence in the process.

Arguably, the court's objective is to ensure that the statutory goals and requirements are complied with. Yet participants at some of the meetings suggested that strict reliance on statutory language may detract from viable business plans, particularly where such requirements are being used by short term creditors trying to derail a workout strategy.

Several participants suggested that telephone hearings should be used more frequently to decide motions. When a matter is resolved, it was suggested that one practice enshrined in protocols could be to send a letter specifying that the matter is resolved, subject to court approval, which would create more consistency and transparency.

Complications for achieving a cross-border protocol can arise where the foreign insolvency system is not court driven, such as in the UK, or where the foreign entity is not formally insolvency in a proceeding. The incentives to agree on court processes are then diminished.

ii. Appellate Court Issues

Another issue going directly to jurisdiction is the failure to encourage comity and cooperation at the appellate level. There is the potential that two decisions with different results would be rendered on the same legal question in two jurisdictions. Courts may cooperate at first instance because of their expertise in insolvency and bankruptcy, but

there are no similar mechanisms at the appellate level. Yet as cases involve more complex corporate groups and cross-border enterprises, the need for such comity is likely to grow.

One suggestion was that if there is an impasse at the juridical level, there should be availability of a process of negotiation that can be considered. However, others pointed out that such a process presupposes that the parties on both sides of the border can see an advantage to a consensual resolution. Often there may be no "win-win" resolution to the dispute.

One unknown is what the outcome would be where appeals of judgments rendered in joint hearings are separately appealed and determined in Canada and the US. For example, in *Nortel,* the appeals were subject to two separate appeal processes, and there exists no coordination at the appeal level.[65] Different appellate processes have different timing and different thresholds for considering issues on appeal, which may result in different appellate outcomes even where the supervising restructuring courts have agreed.

iii. United States Unsecured Creditors Committees

Another important issue identified was that United States unsecured creditors committees (UCC) have increasingly used cross-border protocols to get standing in Canadian proceedings, even though they have no status under the Canadian statutory language. While such standing allows the court to have the benefit of broader stakeholder views, UCC are increasing the amount of litigation before the Canadian *CCAA* courts. They are funded out of the assets of the US debtor company and thus cost considerations do not temper their litigious approach. Canadian creditors end up bearing substantially more court costs because of the increased numbers of motions and contested positions. Issues that previously were negotiated between the parties are being brought to the court for a legal, rather than business, resolution. While these concerns are significant in eastern Canada, participants reported that they have been less so in Alberta and Manitoba.

UCC have been formally recognized in Canada, even where Canadian creditors do not have the advantage of a similar committee to represent their interests. One practitioner suggested that there is a growing literature that the UCC in the US are not helpful; and that they are attempting to maintain an ability to trade and avoid their own fiduciary duty.

[65] *Nortel Networks Corporation, supra*, note 19.

One practitioner at the Toronto meeting observed that a consequence of picking and choosing from the US regime is that Canada has only picked half when it comes to UCC and that can be a problem. She noted that UCC play an important role in the US system, especially with stalking horse bids. Her view was that there are gaps in terms of roles in Canada, in that often unsecured creditors face collective action problems and do not fulfill the role that the UCC fills in the US proceedings. The monitor, in part, fills that role, where it is acting as an impartial officer of the court.

In Canada, in terms of standing, the courts have recognized not only financial creditors, but also social stakeholders. Hence, one view was that just because the UCC aren't note holders in Canada, the court can't exclude them, but should be able to control their contact in the Canadian proceedings. The UCC have some level of legitimate interest in Canada; if the UCC is the last holder of the value, and the Canadian entity is the value, the UCC should have some say. However, others suggested that it is hard to find examples of added value to the proceedings, yet there are significant costs.

iv. Initial Changes to Consider

1. *Canada needs to develop its criteria on treatment of corporate groups, building on the work of UNCITRAL to further develop principles and procedures for the treatment of corporate groups in cross-border insolvency proceedings.*

2. *Canada should propose a mechanism to UNCITRAL for coordination of appellate court proceedings in cross-border insolvency proceedings, or alternatively, provide a leadership role in developing a cross-border appellate court protocol.*

3. *The court should satisfy itself that Canadian creditors have been given sufficient notice, disclosure and the opportunity to make submissions before the court determines COMI in cross-border proceedings, particularly where the request is to find that the COMI of Canadian debtor companies is in the US or other foreign jurisdiction.*

4. *The CCAA court should consider limiting the influence and participation of US unsecured creditors committees in Canadian proceedings, by developing principles and criteria for recognition and scope of participation that align with the overall objectives of the CCAA.*

5. The Role of Lenders and Distressed Debt Traders

There are important challenges currently in respect of the roles of lenders and traders regarding funded debt in distressed circumstances, how they are evolving and the challenges posed by their differing jurisdictions, compositions, time horizons and priorities. Different roles are creating tensions, particularly because of the large numbers of creditors that do not have a relationship with the debtor company.

There are now dynamic creditor pools, not just several banks in the negotiation room. The nature of the creditor base is changing. It is evident from recent cases that the leadership required from an agent to drive a disparate creditor group is significant. Some observations about the different types of creditors and their interests helped frame the discussions at the public meetings.[66]

i. Single Source/Club Deals

The traditional debt relationship model in Canada involved mostly Canadian chartered banks and credit unions. Thus, at the point of insolvency, the debtor company dealt with a known operating lender. In some instances, the single source lender or club deal typically provided ancillary services such as payroll, treasury, credit cards, etc. Such institutions were frequently invested in local communities and concerned about the collateral impact of insolvency, whether on a reputational basis or lending to the supply chain. Hence, such lenders were more likely to be subject to community pressures to amend credits, waive defaults and provide bulge facilities. As a consequence, there were typically lower-value workout deals. The secondary market, if it existed, was thin, and most debt holders lent at par. In most instances, the lender was looking to avoid or minimize a loss, get out or keep the issuer leveraged, and they were not prepared to convert debt to equity.

ii. Syndicated Senior Credit

Commercial lending is no longer based on a traditional relationship model with Canadian banks or a small group of Canadian lenders providing money at par. Now the principal interface between lender and debtor are syndicated creditors. Syndicates can be a mixed bag with the same agent under one set of credit documents and can include: multiple

[66] My very sincere thanks Edward Sellers for his extensive contribution to the discussion of differing types of creditors in this section of the report.

borrowers; different participants in separate tranches with differing maturities; first lien and second lien interests; and original issue discount (OID), or debt not issued at par; and all in multiple currencies. Large syndicates can have in excess of 200 members, such as in the *Canwest* proceedings, and may include non-traditional lenders, including investment funds, at the syndication stage.[67]

There is also significant growth in secondary market trading. This type of debt is characterized by standardized documentation. Investment funds are the primary purchasers, and inter-creditor agreements have developed, but there is some uncertainty as to the enforceability of certain provisions in bankruptcy; for example, whether junior creditors can give up voting rights. These lenders have substantially different roles, in the origination of the loan, bank of account status, and the provision of ancillary services such as payroll, treasury, and credit card services. Moreover, residency can create distinctions between initial lenders and secondary holders.

A number of initial Canadian lenders still have relationships with the debtor company, have investments in local communities and may be concerned about the impact of insolvency. Hence, they are likely more prepared to amend credits, waive defaults and provide bulge facilities. However, other initial lenders today often have no relationships with the debtor company, no investments in local communities, and they are generally unconcerned any about collateral impact of insolvency. Such creditors are typically looking to avoid or minimize a loss, and to keep the issuer leveraged. They are usually not prepared to convert debt to equity in any restructuring plan; although they are often prepared to amend credits, waive defaults and provide bulge facilities.

In contrast, secondary holders typically have no relationship with the debtor company and provide no ancillary services. They are indifferent to the consequences of the insolvency. They have no investments in local communities and are unconcerned about the effects of insolvency on local stakeholders. Hence, they are less likely to amend credits, waive defaults and provide bulge facilities. Often such lenders hold the debt at a substantial discount to its face value and are looking to negotiate a return. In some instances, these creditors are prepared to convert debt to equity.

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[67] *Canwest Global Communications Corp.*, Ontario Superior Court, File #: CV-09-8396-00CL; *Canwest Global Publishing Inc.*, Ontario Superior Court, File #: CV-10-8533-00C; *Canwest Publishing Inc.*, Ontario Superior Court, File #: CV-10-8533-00CL.

iii. Indenture Debt

Indenture debt can be privately placed, public debt, and have zero relationship with the initial and secondary holder. Initially, indenture debt was comprised of both institutional and retail holders. They typically have no relationships with the issuer and do not have investments in local communities or concerns about the collateral impact of insolvency. Indenture holders may have acquired the debt at a discount to face value, even if they are the initial holder.

Institutional holders of such debt are typically looking to avoid or minimize a loss, keep the issuer leveraged and are not prepared to convert debt to equity. They may be prepared to amend credits and waive defaults, but in Canada they have rarely provided bulge facilities and practitioners observe that they always look to "collect on the make whole."

Retail investors typically never participate in negotiations or insolvency proceedings other than delivering a proxy/vote through a broker, if solicited. Indenture debt exhibits many of the same characteristics as syndicated senior credit in secondary market. There are usually separate indentures for separate issues; they are typically secondary holders with no relationship with the debtor company. They usually have no investments in local communities and are not concerned about the impact of insolvency on interests outside of their own. They hold the claim at a substantial discount to face value and seek to negotiate a return; and many are prepared to convert debt to equity.

iv. CDS Counterparties

Many syndicated senior credit and indenture debt holders hedge their large value credit risks with credit default swaps (CDS). CDS are now a large component of initial lender protection; the debtor never knows who the protection seller is or the degree of hedging. Since inception of CDS in the 1990s, banks' market share has decreased and investment funds and other market participants' share have increased.[68] There is a serious lack of transparency in the CDS market; there is no public record of specific swaps; buyers and sellers may deal with broker-dealers with ultimate exposure several steps away and not

[68] British Bankers' Association Report 2006. Banks' share as buyers of credit protection decreased from 81% in 2000 to 59% in 2006, while hedge funds' share during such period increased from 3% to 28%. Banks' share as sellers of credit protection decreased from 63% in 2000 to 44% in 2006, while hedge funds' share during such period increased from 5% to 32%. See Elizabeth Murphy, Janis Sarra and Michael Creber "Credit Default Swaps, the Devil is in the Details", *Annual Review of Insolvency Law*, 2006 (Toronto: Carswell, 2006).

readily identifiable. “Cascading swaps” as swaps start to settle on commencement of an insolvency proceeding make it difficult for debtor companies to know who holds the actual claims. Economic interests have become bifurcated due to CDS; the lender has control, the protection seller has the economic risk. In extreme cases, those parties that bought credit protection on loans they did not hold may buy loans in the secondary market for the sole purpose of forcing default. The other issue is the shifting nature of the financial products. Every time legislative amendments address something, a new financial instrument is born.

The need for transparency of CDS and other derivatives holdings was raised at every public meeting. While one practitioner queried whether greater disclosure of holdings would have any tangible benefits or temper gaming conduct, most participants at the discussions thought that parties would conduct themselves more responsibly if their real economic interests at risk were transparent.

Lenders that are CDS protection buyers often have decreased incentive to engage in oversight or monitoring of the debtor company and may find it in their interests to “tank” the credit and get paid on their swap. An example was *Abitibi,* where the lenders had CDS, so they stood to benefit from bankruptcy.[69] Practitioners discussed how CDS holders in the Abitibi proceeding “pushed” the debtor into *CCAA,* then got out via an International Swaps and Derivatives Association (ISDA) auction. CDS also make it more difficult to get the required majority for debt restructuring under *CCAA* proceedings.

Originally, when protection was given to EFC, what qualified was is much different than current products. The original logic was that if a party has a forward contract and it is now unclear if it will be able to perform, the party should be able to exit and get the coverage somewhere else as soon as there is a problem. Hedging is often a form of insurance or risk mitigation. The logic is still valid and it covers interest rate swaps, currency swaps, and forward contracts. The challenge is how to parse protection for these contracts out from some of other structured financial products. All of the new and different kinds of structured financial products provide lots of opportunity for mischief, such as taking a position as being fully protected while actively working against the restructuring process. There was broad support for going back and looking at what protection extends to these products, to find out exactly what the concerns were at the time and how they apply to these different types of products. The court should also be granted explicit authority to address abusive behavior.

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[69] *AbitibiBowater Inc.,* Quebec Superior Court, File #: 500-11-036133-094.

CDS can be the cause of insolvency, such as in the *Lehman's* failure.[70] Derivatives currently are permitted to function outside of the normal parameters of the *CCAA* stay, as they fall within the definition of "eligible financial contract". The decision to exempt derivatives from the stay provisions of the *CCAA* was not really subject to public policy discussion in the last round of statutory amendments. The derivatives market is now entirely different than when the eligible financial contract (EFC) protection was put into Canadian legislation and thus, now deserves a serious policy discussion.

One issue is that one can only account for a net exposure on the balance sheet if there is an exemption; otherwise there would be a need to record the full exposure on the balance sheet, thereby affecting leverage ratios. Participants across Canada suggested that continuing this protection may still not make sense. When Parliament excluded EFC, it involved a narrow category of swaps and futures. The definition is now so broad that it catches all new structured financial products, for many of which there is no compelling reason to grant automatic protection. The exclusion also developed when creditors still had "skin in the game", prior to the degree of uncoupling of legal and economic interest that exists now. If such protection is to be continued, there should be some constraints. The court should be given the discretion to determine whether or not such protection should be given, taking into account the relevant circumstances.

Lenders and insolvency practitioners at the Montréal meeting observed that there is considerable uncoupling of legal ownership and economic interest under CDS, as was evident in the Quebecor proceeding.[71] CDS holders frequently do not care about the outcome of the proceedings. The primary rationale for not staying derivatives during *CCAA* proceedings is the avoidance of systemic financial risk and the importance of a unified international approach to the treatment of such instruments in insolvency situations. One suggestion in Toronto was to redefine the nature of interest in the debtor's restructuring to recognize the role of CDS. If the *CCAA* is to be interpreted in a purposive way, it must recognize when people have conflicting interests and are working actively against the goals of the statute. The courts need to take into account the issues generated by the uncoupling of economic interests at risk and legal claims. The Canadian insolvency regime is based on the assumption that creditors and the debtor share a common goal of maximizing recoveries. As a result of CDS, creditors often look

[70] *In re Lehman Brothers Holdings Inc.*, Chapter 11 Case No. 08-13555 (JMP).
[71] *Quebecor World Inc. (Arrangement relatif à)*, Quebec Superior Court / Court of Appeal, Dossiers #: 500-11-032338-085, 500-09-020687-109.

at recourse to the counterparty as their best exit strategy and will act to trigger the CDS, rather than focus on what is best for the stakeholders, the company or the business.

The current lack of transparency regarding economic interest means that the debtor company and other creditors are not aware of who is bearing the real economic risk of firm failure, inhibiting the potential for meaningful negotiations and a viable business restructuring plan. There should be mandatory disclosure during a restructuring proceeding of the real economic risks at stake, including disclosure of the amount of debt that has been hedged by creditors that seek to exercise their voting or oversight rights in a restructuring proceeding. Arguably, the court should be granted authority to determine the scope and timing of such disclosure, including making determinations in respect of confidentiality, limiting access only to parties in the proceeding, and determining any exceptions, such as for *de minimus* holdings.

However, in Montréal, there was some discussion as to the practical benefits of disclosure of real economic interests, and whether the court would have any authority to adjust the power dynamics even if it knows the degree of hedging.

One practitioner at the Toronto meeting observed that the traditional concept is that if a party holds an economic interest in a particular case, it is supposed to vote with that economic interest in mind; however, there are instances in which some parties hold equity, then go to the market and buy the debt to vote following the interests of the equity class. She suggested that there should be disclosure as to who holds what votes following what interests.

Others noted that in the current bond markets, it is difficult to reach the beneficial owners. The record lists often do not match, particularly across borders. There are huge gaps, and despite all the costs of trying, in some instance, it is impossible to reach them. As a result, the parties and the court never know the price and who bought the debt. When there is a very large issue of bonds, it is very difficult to devise a going forward strategy. Record lists cannot easily be constructed by the monitor.

It may be feasible to ascertain who the creditors are at the point of a vote, at the end of the process, but the process before that has been made very difficult. Moreover, in order to preserve liquidity among creditors, the record list necessarily changes constantly. It is hard to negotiate if the debtor does not know who the creditors are.

A senior Toronto practitioner observed that two or three broad themes have been surfacing in relation to stakeholder dynamics and stakeholder control. In the context of changes to the scope and nature of liquidity facilities, he observed that there is potential impact on the track of the restructuring case. If a party has an actual or functional veto, it can have a material impact on what the debtor can do and how it could or ought to proceed.

One member of the judiciary observed that there is often so much going on that the court does not know about, which sometimes influences its thinking. The positions taken by the parties are so counter-intuitive that the court knows that there is hedging; it cannot make its decision on that basis, but it is obvious. Then the question becomes who is bearing the costs of this lack of transparency.

The framework was created based on economic interests that creditors have at risk. A challenge is how to apportion and balance risk and respect the hierarchy of creditors when some of the original fundamental underpinnings are different now.

One option is to amend insolvency restructuring legislation to include credit derivatives within the mandatory stay of proceedings, except with leave of the court on the basis of unfair prejudice, the standard currently used for other creditors to be exempted from the stay. The court could then exercise oversight of the clearing process in a measured way that assists with the risk management aspects of the products and slows the speculative market. Such an approach could ensure that derivatives continue to settle where they are not adversely affecting the workout process, but could be stayed where the court was persuaded that it would prevent inappropriate conduct or would preserve going concern value pending negotiations for a restructuring plan.

Another suggestion was that a first step could be that derivatives are not allowed to continue to settle. Rather than shifting incentives of a CDS purchaser, who is a creditor, there is some room to negotiate. The debtor's incentive may be to push the creditors into the *CCAA*, because of the lack of transparency. Second, once the debtor files, there is perhaps the need for a short window to let the debtor think about the effects.

One practitioner observed that if EFC are included as part of the stay, it is potentially exposing a provider to a lot of volatility and potential prejudice; yet one concept of the *CCAA* is that the party should not be subject to prejudice when moving forward with restructuring. One possible approach suggested in Vancouver and Montréal is a short

period of time for the debtor to evaluate the EFC, perhaps five to ten days. Several other practitioners suggested that where the debtor company has a direct interest in an EFC, there could be a temporary short stay, creating a window, perhaps a week, where the debtor could decide what EFC to keep and what not to, similar to the current treatment of executory contracts.

The meeting in Toronto pointed out that CDS or other derivatives and other EFC are discrete products raising different concerns in insolvency files; and although there are some interactions with respect to CDS, there are two types of third parties to the *CCAA* proceedings. One financier at the meeting observed that a CDS is not an EFC. Although it is listed as an EFC, the things that are generally exempted from the stay are contracts that are entered into by the debtor itself.

Others noted that "flip clauses" have become very popular in derivative contracts. These clauses provide that the defaulting counterparty, even if in the money, is deprived of the benefit of such a contract. Where the default is an insolvency event, the practical effect of these clauses is to deprive the insolvent estate of an asset. It was pointed out that the US and UK courts have taken conflicting positions on this issue. Several practitioners suggested that Canada consider codifying "fraud on the bankruptcy" in our insolvency statutes so that situations like this one can be redressed.

Another issue discussed was whether the court’s consideration of any restructuring plan should take account of economic interests at stake. This weighing of interest could be accomplished in two different ways. Voting on a restructuring plan could be premised on the real economic interests at risk in the firm’s insolvency. Currently, our voting system globally is based on provable claims. However, the growth of credit derivatives means that the voting power of financial institutions that have partial or full credit default swap coverage may be disproportionately large compared with the amount of economic risk, skewing voting outcomes and harming the potential for restructuring an economically viable company. This alternative would require some recognition of the rights of cash settled swap holders, who are now the residual risk holders. Alternatively, legal voting rights could be unaffected, but the court could be granted authority to weigh actual economic interests at risk when considering parties’ positions and exercise of voting rights.

In terms of realizations through CDS, the amount of compensation is not limited to actual loss, as parties do not actually have to hold the referenced asset. Where the CDS

specifies physical settlement, there is a successor holder that shows up, with which the debtor company must try to negotiate a plan of arrangement or compromise. The protection seller becomes creditor on delivery of underlying debt and the debtor is faced with new parties in negotiations. However, there can be delay between demand and payment on swap, which may be greater than 60 days. Accordingly, it is difficult to establish plan lockup with a revolving door of CDS holders as swaps are settled. Buyers who do not hold reference debt have to obtain debt in market; there is a supply/demand issue.[72] For cash settled CDS, the holder may have a subrogated right but does not necessarily exercise it. The ISDA has developed auction protocols for cash settlement in such instances. On a cash settlement, there is no passing of title or right of subrogation. The protection buyer continues to have legal claim, but with a reduced or eliminated exposure.

In disclosure of economic interests, one issue was how to define what the economic interest is. For example, a bond holder may receive a three million payout from a CDS, still have a one million claim, and then the question is any effect on negotiations for a workout. Total income swaps may change behaviour, since the payout isn't until the end of the proceeding. The difficult issue may be that if a party has insured the risk, its claim should perhaps be discounted. Another participant queried whether accounts receivable insurance should be in place.

A participant in Montréal observed that we have lost attention of the fact that there is a run for security as there is a run for the asset. It begs the question that if we try to categorize these contracts further, how can the parties or the court determine who is a true creditor or not a true creditor, and how does one set the threshold of economic interest. One possible rule is to require that if a creditor is going to take an active role, then it must be transparent as to its holdings. In the US, the impetus for changing its disclosure rule was that the debtor was using the disclosure as a club to get creditors to back off on the negotiations. They were trying to get them to disclose their trading patterns.

It is also important for courts to set timely claims bar dates, so that for CDS with physical settlement, the debtor need only bargain with parties as of that date, and not face a continually revolving door of CDS settlements that make the negotiating parties a moving target. While Canadian courts have established such dates in proceedings, there is some unevenness in such practices in cross-border proceedings.

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[72] See *Delphi,* for example, where there was $25B CDS written on $2B debt.

Practitioners observed that one concept that has been endorsed in the US and EU is the clearinghouse concept. Canada has draft legislation that should be considered for its impact on insolvency proceedings. Moreover, it was pointed out that Canada should not be out of step with the US approach to the law or there will be tremendous implications for the market in how counter-parties could unwind their derivatives. They might think that they are in the money, but then when it is unwound, they are out of the money. There should be a level playing field.

v. Amendments to Credit Documentation

Single source/club deals involve bilateral discussion between the debtor and lender requiring the lender's agreement. Typically, covenant and rate changes can be relatively easily accomplished, with covenant and rate changes typical, fees payable and usually there is loss minimization. For syndicated senior credit, it will effect all administration and changes through an agent that has the relationship with the lenders. As several practitioners observed at the Toronto and Montréal meetings, undercurrents will impact the ability to successfully achieve unanimous consent. Parties may buy in because they want the ability to exercise a veto. They may have a steering committee of lenders to build consensus or address conflicts, covenant and rate changes possible, and fees payable. Unanimity provisions are typically built into most senior credit agreements, including prevention of changing essential aspects and economics of the deal, such as principal, interest, maturity date, amortization of principal, security, etc.

Such creditors have an effective veto outside proceedings. Hence the only way to amend credit is then through a proceeding with lower voting thresholds, such as under the *CCAA* or *CBCA*. For example, in *Canwest LP,* with so many individual lenders involved, it took the agent some time to get numbers to the point where there was consensus among the company, the agent and their representatives that lender support was such that the vote on the credit bid would pass. Even then, there was technically a risk that the plan could be voted down once the plan was filed and the formal vote conducted. Such agreements have had an impact on subordinated indenture debt.

In terms of indenture debt, there are usually disparate holdings. They effect most administration and changes through the indenture trustee. Thus one senior Toronto practitioner observed that it is much more challenging to effect a coalesced dialogue and get consensus for indenture debt than under the syndicated space. They may have an *ad*

hoc committee of holders to build consensus. Covenant and rate changes are not typical.[73]

Exit and workout options for lenders have increased due to an active secondary market. They can attempt to extend or restructure with view to increasing recovery at later date ("extend and pretend"). Alternatively, they may rework the original credit; sponsor restructuring; or sell debt and security at a discount, handing it into secondary market. Creditors are looking for a quick, inexpensive process. They are concerned about the impact on capital requirements; and how to enforce their rights and liquidate collateral without a lengthy, intensive and expensive process.

In terms of transparency of holdings, several participants observed that the standards should be consistent as between the *BIA* and *CCAA.* In some cases, there have been privacy issues in that it is argued that the names of shareholders and creditors should not be disclosed. Under the *BIA,* any creditor has the right to know what the trustee knows even before the claims process has been completed and in Calgary and Toronto, participants suggested the same is needed for *CCAA* proceedings. A number of participants also suggested that commercial secrecy claims are over-used.

vi. Influence on Restructuring

The complexity of these types of creditors has a significant influence on any negotiations for a restructuring plan. For club deals, there are discussions with various lenders for bilateral consents. For syndicated senior credits, the agent and/or steering committee of senior lenders is the party interested in the workout negotiations. There are duties of confidence (banks) and restrictions on use of information. Other lenders trade with only public information, and the asymmetrical information often creates uncertainty in the senior lending group.

As participants at the Toronto meeting observed, for club deals, syndicated debt and indenture debt, there are usually now *ad hoc* committees, with holders trading in and out, and occasionally there is a long-term holder as sponsor.[74] Professionals get restricted information, but holders allegedly get no non-public information. Under such arrangements, there are no duties of confidence, and there is an ability to continue to

[73] One practitioner observed that fees or enhanced priorities or recoveries are typical; amendment thresholds less than 100%, less than 75% (some at 50% +1) and there are many of the same issues as syndicated senior credit.
[74] See *AT&T* where there was a continuous committee without requirement for any specific holder to be on committee, which had power to veto plan amendments prior to implementation.

trade. However, it raises the issue of the legitimacy of actions of advisors to holders in terms of how they get informed instructions throughout the *CCAA* proceeding.

Secondary holders of debt may seek to assert control in a restructuring by buying debt across classes and providing covenant amendments, DIP financing or support agreements under strict covenant controls. They may try to constrain the debtor company from bringing motions, engaging with others freely or considering strategies that are in best interests of all stakeholders. They tend to buy a single class of debt through several entities, with control numbers and value. They can pressure for timely turnaround that may generate short-term realizing on their interests, rather than supporting long-term viability of business.

Another growing issue is that foreign based claimants have concerns as to whether they are bound by a Canadian process and plan. The jurisdiction of the Canadian court to bind foreign creditors through a *CCAA* process will depend on the debtor's COMI, whether the Canadian proceeding is recognized as a foreign main or foreign non-main proceeding, and whether parties attorn to its jurisdiction. Ancillary proceedings may be required in the foreign jurisdiction, such as US Chapter 15 *Bankruptcy Code* proceedings.[75]

vii. Challenges and Conflicts Created by Economic Interests

Practitioners observed that the agent is often supportive of the debtor company, but is motivated by its fee for creating, closing and selling sustainable credit, provision of ancillary products and services to the issuer, and a desire to avoid loss. Initial holders are concerned with the credit-worthiness of the face value of loan and rate of return; the provision of ancillary products and services to issuer; and avoiding loss. Agents and initial and secondary holders vary in respect of priorities, value and what is needed to avoid a loss or receive a return.

Secondary holders are often less concerned with credit-worthiness of the face value of the loan, although that value drives pricing; and they are less concerned about provision of ancillary products and services to the issuer. However, they are very concerned with generating a real return. It is important to distinguish between arbitrage holders and enterprise holders. Arbitrage holders have short time horizons; they are just there for the spread and will seek an exit through a trade or plan implementation. They are generally not interested in equity fund limitations or redemption requests and they may induce

[75] Examples cited by practitioners include the Maax, SemCam and Angiotech cases.

premature emergence from restructuring, creating a higher probability of relapse. Indentured debt is often held by arbitrage holders.[76] Enterprise holders of debt have a longer-term time horizon; examples include Cerebus in *Air Canada*;[77] Brookfield in *Stelco*;[78] and Goldentree in *Canwest*[79]*.* Generally, these creditors seek to equitize a portion of the debt, such as in a "loan to own" strategy. Secondary holders typically have widely divergent acquisition pricing and therefore divergent thresholds for return.

There are also challenges and conflicts in respect of control aspects of the restructuring process, including covenant compliance embedded in DIP facilities; support agreements; and plan sponsor agreements that may set voting thresholds, classification and voting vetoes.

Holders of multiple positions in the debtor company's capital structure are not required to disclose who they are, what they hold and what is being voted. Such creditors buy unsecured debt quietly and then buy equity publically as a loss leader to effect a market reaction to drive up the price of unsecured debt because equity market is signalling prospect of recovery.[80] They are subject to *Securities Act* compliance and orders of the supervising court; see, for example, *Uniforet*[81] (requirement for evidence of identity, holdings and acquisition price) and *Stelco*[82] (refusal of standing of *ad hoc* committee before court had disclosure of who they were and what they held). They can hold and vote an interest in one capital pool without regard for their other interests or to hedge them. They purchase unsecured debt to control the class and confer benefits on another class.[83] There is no "majority of the minority" test in debt securities, but there is in equity securities; here, there is a conflicted interest recognized, in terms of disclosing who held what. The court could force disclosure regarding the nature of holdings and who actual

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[76] Edward Sellers suggests that there is a need to consider support agreements, promises to support with controls verifying conduct; purchase across class to "cross-dress" and acquire vetoes, which minimizes the prospect of a collateral based option, *supra*, note 66.
[77] *Re Air Canada*, Ontario Superior Court, File #: 03-CL-4932, Ontario Court of Appeal, File #: M30712, C40198, M29922, M29923.
[78] *Re Stelco Inc.,* Ontario Superior Court, File #: 04-CL-5306, Ontario Court of Appeal, File #: C46248, C46258, C46266, C46916, C44436, M33171, C45225, C43914, M33099, C44332, C42388, M32289, M32379, M32266, M31848.
[79] Canwest, *supra* note 17.
[80] Douglas Baird and Robert Rasmussen, "Anti-Bankruptcy", (2009) University of Southern California Law, Law and Economics Research Paper Series USC CLEO Research Paper No. C09-8; University of Chicago, Olin Law and Economics Program, Research Paper Series Paper No. 470; http://ssrn.com/abstract=1396827.
[81] *Uniforet Inc. (Bankruptcy), Re,* Quebec Superior Court / Court of Appeal, File #: 500-05-064436-015, 500-09-012556-023.
[82] Stelco, *supra* note 78.
[83] See for example, *Uniforet;* but see *British America Nickel Corp.* where special powers were conferred on a majority of a class to enable that majority to bind a minority, they were to be exercised for the purpose of the class as a whole, and not merely individual members only.

held what when evaluating classification, which could be important to the successful achievement of a plan of arrangement.

Creditors' committees assume homogeneity among members, ignoring the effect of CDS, collateral interests or a desire to remain unrestricted in trading. Creditors often do not want to participate because they do not want to stop trading; therefore the instruction or oversight is not sufficient. Such committees assume fully instructed professionals, yet it ignores the lack of restricted principals. There is also an issue in respect of anonymity and low transaction costs for creditors creating a frictionless environment where agreements cannot be readily reached or made to stick; essentially a form of "free pass" for creditors to come in and out without having to resolve the issues.[84]

Secondary market participants in Canadian proceedings are primarily located in the US, and thus there is frequently no "real and substantial connection" of holders to Canada. As a result, they may have limited regard for societal or collateral impact of insolvency.

The complexity of types of debts and debt instruments, the differing sophistication and strategies of creditors, the active market in debt trading and the speculative aspects of the market all create tremendous complications for the debtor company in its efforts to restructure. Where multiple entities and jurisdictions are implicated, the complexity is magnified. Participants at the public meetings raised the question of whether a more fundamental revising of the framework might be necessary, to better align the objectives of the legislation with the reality of these complex debt structures and motivations.

viii. Initial Changes to Consider

1. *The court should require full disclosure of the type and quantum of debt held and real and beneficial ownership, when evaluating classification of creditors.*

2. *The court should satisfy itself that any creditors committees are engaged in oversight and appropriately represent the interests of the classes of creditors represented by the committee.*

[84] Conditioned by debtors underwriting the committee process. But see UK style facility agreements, whereby the original lender of record votes and must be regulated; secondary market holders are participants; the result is lenders and secondary market working together. Sellers, *supra*, note 66.

3. *The court should take into account, in the balancing of interests, whether creditors' committees that have revolving membership due to continued debt trading are in fact representative of the views of creditors in the proceeding.*

4. *There should be mandatory disclosure during a restructuring proceeding of the real economic risk at stake, including disclosure of the amount of debt that has been hedged by creditors that seek to exercise their voting or oversight rights in a restructuring proceeding.*

5. *There should be serious consideration of removing the exclusion from the mandatory stay provision for derivatives and related structured financial products under the CCAA. One option is to include CDS and other credit derivatives within the mandatory stay of proceedings, except with leave of the court on the basis of unfair prejudice, the standard currently used for other creditors to be exempted from the stay.*

6. *There should be clear criteria developed in respect of when and the extent to which the CCAA stay should apply to derivatives, including credit default swaps.*

7. *Consider statutory amendments that impose a very short stay period on eligible financial contracts, and provide a process for determining whether they should be stayed or disclaimed.*

8. *The courts should be granted authority to reduce the voting value of claims where creditors have little or no economic interest in the debtor because they have purchased CDS or other derivatives.*

9. *The court's consideration of any restructuring plan should take account of actual economic interests at stake.*

10. *Proposed central counterparty clearing facilities should be examined for their potential impact on restructuring proceedings under the CCAA.*

6. The Appropriateness of Using the *CBCA* or Similar Corporations Statutes to Restructure Insolvent Companies

As noted above, there have recently been a number of cases that utilize the *Canada Business Corporations Act (CBCA)* or similar provincial corporate statutes to effect a corporate restructuring in which one or more of the entities in a corporate group are insolvent.[85] Usually corporate statutes are used for complex corporate reorganizations or transactions involving healthy businesses.

A number of insolvent businesses have opted for this strategy under corporate law because managers remain firmly in control and there is no oversight of a monitor; no mandatory obligations towards creditors; the company can avoid any stigma that it perceives exists in respect of using an insolvency proceeding; and it may prevent downward pressure on the value of the financially distressed entity's assets and prevent an undue increase in its cost of credit.

The process under a corporate statute can be quicker than a *CCAA* proceeding, sometimes effected in a month or two. In some instances, debt securities are exchanged for new debt securities issued by a newly solvent company.[86] In other cases, the approach is "amend and extend", essentially establishing new maturity dates for an appropriate fee. A third option is that debt is exchanged for equity.

There are eligibility requirements that the court has established. Pursuant to federal corporations legislation, the applicant must be a *CBCA* corporation and the arrangement may include a "body corporate" from any other jurisdiction. At least one applicant must be solvent. Special purpose entities have been permitted as applicants.

Increasingly, in Canada, the arrangement provisions of corporate statutes are used for financially troubled businesses, often in a pre-packaged deal. Such files are limited to securities that are debt obligations, i.e., "a bond, debenture, note or other evidence of indebtedness or guarantee"; not generally trade debt or other liabilities. All affected classes usually vote, including equity, except where there is a mixed *CCAA* and *CBCA* proceeding. The *CBCA* Director can also require a shareholder vote where the proposed arrangement fundamentally alters security holders' investments.

[85] The references in this section are to the *CBCA,* but apply generally to other provincial corporations statutes.
[86] See for example, *Tembec Inc.* proceeding.

In terms of the threshold of creditor support that is required for approval of the plan of arrangement, none is specified under the *CBCA*, but practitioners advised that it is typically two-thirds the value of outstanding debt; and the court has discretion to disregard a "no" vote by an affected class. To date, courts have not required debtor companies to also meet the "head count" requirement in terms of the numbers of creditors supporting the plan. Practitioners advised that other corporate statutes, such as the British Columbia *Business Corporations Act,* contain an express threshold for approval.

In terms of proceedings under corporations legislation, the court may make "any interim or final order it thinks fit".[87] A stay has been granted in some cases where the applicant is in financial difficulty; however, a stay is not always requested. There is no monitor in a *CBCA* arrangement proceeding, which can lead to a gap in terms of an impartial officer to give advice to the court on the integrity of the process or the outcome. There is no express authority to authorize DIP financing. The process assumes pre-filing credit terms continue in the ordinary course. Applicable securities law or other regulatory requirements may necessitate shareholder approval under these arrangement provisions, depending on the proposed level of dilution of equity or where the plan comprises a fundamental change within either corporate or securities law, particularly where dilution of equity holdings is significant.

The applicant must notify the *CBCA* Director in advance of seeking an arrangement. The Director has a published policy statement regarding use of *CBCA* reorganizations by financially distressed corporations, in which the Director has noted that corporations must be in compliance with the solvency provisions of the legislation.[88] Notice to stakeholders is given as directed by court and as required by securities laws. Often notice is given only to affected security holders. An information circular is sent to security holders prior to vote on plan. The *CBCA* Director requires disclosure of enough information to permit creditors to make an informed decision.

The reasons for choosing the *CBCA* or similar corporation statutes instead of the *CCAA* include: reduced negative impact on goodwill; avoiding disruption of trade creditor and customer relationships; and in some cases, avoiding contract defaults. It can be an effective tool for pre-packaged deals involving public debt and/or bank debt, and can be

[87] Participants pointed out that an exception is the Alberta *Business Corporations Act,* which does not contain this language.
[88] "Policy of the Director Concerning Arrangements under section 192 of the *Canada Business Corporations Act",* http://www.ic.gc.ca/eic/site/cd-dgc.nsf/eng/cs01073.html January 2010.

an alternative to an exchange offer for public debt. Two-thirds majority of debt can usually carry the class, and a headcount is not required. The process is usually less expensive than a *CCAA* proceeding.

A plan of arrangement that is an adjustment of debt can be recognized under Chapter 15 of the US *Bankruptcy Code* and granted relief in respect of the compromise of debts and restructuring of bank debt. Practitioners in Toronto noted that in at least one case, MEGABrands Inc., the US Bankruptcy Court allowed such an arrangement.

However, there are issues associated with using the *CBCA.* The *CBCA* is quite clear that it cannot be used if a debtor is insolvent, but there are numerous tricks and exceptions that have developed across Canada. In Montréal, it was noted that even if one cannot restructure an insolvent company under the *CBCA,* parties are bypassing the solvency requirement by creating a solvent shell company and then restructuring it that way. Practitioners in other provinces reported the same types of strategies.

Many participants suggested that if the debtor is insolvent, it should use the *CCAA*, and if it is solvent, it should use the *CBCA*. There is a risk of abuse because there are no parameters or guidelines set up for it. It was noted that under the *CBCA*, the court can grant a stay of eligible financial contracts, thus bypassing insolvency legislation by using corporate legislation. An alternative view in Calgary was: “If nobody complains, why not use corporate legislation; the double majority is not required and thus the support of two thirds of the value of creditors’ claims is easier to achieve and the debtor is not bogged down in a whole bunch of claims processes.”

Concern was expressed by numerous participants at the public meetings that there may not be sufficient safeguards in the process to protect creditors. One issue is whether it is appropriate to bypass the solvency requirements through the use of special purpose entities.

If the goal is approval of a pre-packaged plan of arrangement, it may be appropriate in some cases, particularly if all affected stakeholders have a vote. But for other insolvency proceedings, the lack of a monitor, of express protections for creditors, of court oversight of the negotiation process, and rights to notice and bargain for unsecured creditors may all create unfairness in the workout process. Moreover, a proposed sale process may not have the impartiality and oversight associated with the monitor and the court in a *CCAA* proceeding.

It is difficult to get a stay under the *CBCA* in Québec. Practitioners noted that in the limited situation where stays have been granted under the *CBCA,* it was for a very limited purpose. One practitioner observed that for the court, the main difference with the *CCAA* is that the court knows that the parties will come back to the court within thirty days at the most.

In Vancouver, practitioners observed that a question arises as to whether a *CBCA* process can stay other entities; such as where there is a *CBCA* principal debtor and a bunch of non-*CBCA* entities that are guarantors. Another question is whether there should be use of a *CBCA* arrangement to bind creditors of non-*CBCA* entities. Yet another difficult question is whether corporation statutes can be used to deal with debt in Canada where the primary organization is in US.

One insolvency practitioner in Montréal observed that there is also the fact that one can compromise bank debt with a corporate arrangement, suggesting that it is time to clarify the use of such legislation. He has seen it being used to force issues between the financiers or a difficult syndicate.

One participant observed that in cases such as *Abitibi-Bowater*[89] and *Canwest*[90]*,* the debtors did not want to declare that they were insolvent, but they ended up having to admit insolvency. They wanted to make sure that all the suppliers would continue to provide services. Participants in Toronto observed that the *CBCA* arrangement provisions cannot be used to disclaim underperforming contracts, terminate leases or make an assignment of contracts. Moreover, most, if not all, corporate statutes do not have criteria set out in them in respect on when it is appropriate to conduct an asset sale.

A concern was the appropriateness and flexibility of fitting cases into the *CBCA* and similar corporations legislation. One Calgary practitioner suggested that there has been a spike in the number of cases under corporate statutes because of the downturn in the economy. One serious concern was the scope of releases being secured. If the plan is only dealing with securities, the directors and officers only get releases that are as broad as what is being restructured, but it was suggested that the court needs to be concerned with scope creep, in that more and broader releases are being sought. In Ontario, it was

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[89] *AbitibiBowater, supra* note 7.
[90] Canwest, *supra* note 17.

suggested that the courts are now more cognizant of too broad a scope of third party releases.

There was also a lengthy discussion in Calgary that given the risks and unevenness in treatment of cases, perhaps something could be added to the *CCAA* to accomplish the same things, responding to the issues that parties are trying to get addressed in a *CBCA* proceeding, while at the same time ensuring appropriate oversight of the process.

One practitioner observed that under the *CBCA*, the directors don't have to say that they have been involved in a restructuring in a Personal Information Form (PIF) required for publicly traded companies by the TSX and TSX Venture Exchange. Under the *CCAA*, a director is required to disclose this proceeding in the PIF.

Another suggestion raised in several meetings was that the insolvency requirement under *CCAA* could be relaxed, such as granting access to the statute without the insolvency requirement. Such an amendment would be significant, and in terms of interface with corporate and securities law, would have to be aligned nationally. It would align Canada with the definition under the US *Bankruptcy Code.*

Interestingly, participants at the Calgary meeting pointed out that the *Alberta Business Corporation Act* (ABCA) does not have a solvency requirement. It also doesn't have a broad discretion for the order that the *CBCA* has, and is unclear regarding availability of a stay.

It was suggested that if there is an insolvent company and part of the solution is restructuring the other securities, there is a legitimate reason for wanting tools that allow parties to do that. Most of the business corporations statutes have a link to the *CBCA* that says you can do anything that you could otherwise do in a corporations statute. In Calgary, a practitioner observed that it is important to remember that when the company is not paying all its creditors, its shareholders are not at the table as their interests are most likely already underwater.

i. Initial Changes to Consider

1. *Consider amending the insolvency requirement under the CCAA to specify circumstances in which solvent debtor companies could file for a plan of*

arrangement or compromise under the CCAA, with criteria that protects both debt and equity holders.

2. *Consider amending the CCAA to include provisions responding to the issues parties are trying to address under CBCA and other corporate arrangement proceedings.*

3. *Consider amending the CBCA to expressly allow special purpose entities to be applicants to meet the solvency test.*

4. *Develop criteria that the court can use to determine the length of time and scope of the stay under the CBCA and similar statutes.*

5. *Consider restricting CBCA arrangements to pre-packaged plans of arrangement, rather than insolvency workouts more generally.*

6. *Consider what distinction needs to be made between bodies corporate and entities affected by a stay.*

7. *Consider statutory language that suggests that the CBCA should not be used when the same objectives can be achieved under CCAA or the proposal provisions of the BIA.*

8. *Consider whether use of CBCA arrangements should be able to bind creditors of non-CBCA entities.*

9. *Consider whether statutory language is required to have the court appoint an impartial insolvency professional as its court appointed officer in CBCA or other arrangement proceedings under corporate statutes where one or more of the entities in the proceeding are insolvent.*

10. *Make director reporting under Personal Information Forms under securities law consistent as between the CCAA and corporations statutes.*

7. The Role of the Monitor

Insolvency professionals play a pivotal role in insolvency workouts, regardless of the size of the business. Most of what insolvency professionals do is assist in designing strategies

for a reallocation of resources, taking unproductive assets and placing them where they are likely to be best deployed. Most directors and business managers do not know how to deal with managing insolvency, and hence insolvency professionals become essential to successful resolution of financial distress. In *CCAA* proceedings, monitors are relied on by the courts and the parties to provide information and their views on the financial condition of the debtor, the efficacy and fairness of sales processes or DIP financing arrangements, and their impartial opinion on a host of other issues that arise during the proceeding. Integrity and independence are hallmark attributes of a good monitor.

Yet monitors currently face a number of challenges. In most instances, their views are highly respected and the courts and the parties accord a high degree of deference where the monitor is acting in an impartial manner as an officer of the court. However, outside of the court room, monitors and other insolvency professionals are, in some cases, being aggressively challenged in their conclusions, particularly by sophisticated parties with their own agendas.

There have been cases in which concerns have been raised about the monitor appearing to be too closely aligned with the debtor company, playing an advocacy role. Monitors sometimes fill a governance void; however, in such cases, in order to preserve the role of the monitor as independent and impartial, the debtor and creditors may need to consider the use of a CRO or other governance alternative. The difficulty with the monitor in a more direct governance role is that other stakeholders have less confidence in the insolvency professional’s views and more issues are brought to the court. Practitioners across Canada advised that, increasingly, matters are brought to the court that should have been more administrative and that increasingly, there are complaints about the monitor descending into the negotiation arena. Such challenges in the court reduce the administrative efficiency of the proceeding and increase the costs for all stakeholders.

One practitioner in Calgary observed that such a trend in turn could mean more lawsuits against insolvency professionals, or more challenge to their opinions brought before the *CCAA* court. One question discussed at the public meetings was, therefore, how to adjust the framework to allow greater use of effective turnaround managers and other businesspeople to devise possible going forward solutions, relying on insolvency professionals to use their integrity and impartiality and their accountancy and workout skills to help identify options.

The monitor's role has continually evolved since its inception. The 2009 amendments granted an enhanced role, accompanied by greater independence requirements. While the debtor company is the driver and the advocate for the company's continued existence, the monitor can offer its insights and expertise, but it must be aware at all times of its obligation to balance multiple interests. One new challenge, as indicated by the discussion of derivatives above, is how the monitor can consider all interests when there has been an uncoupling of legal and economic interests that may skew creditor behaviour in the negotiations.

The monitor is also privy to a great deal of information regarding the bargaining dynamics, including the role being played by foreign creditors through unsecured creditors committees or by distressed debt investors. The court relies on the monitor to offer a balanced and impartial perspective, but there is some delicacy in respect of the amount of disclosure about gaming or other behaviour during the negotiations that should be brought to the court's attention. There is a need to preserve the negotiation aspects of the *CCAA,* which is one of its real strengths, while at the same time ensuring that the monitor has the confidence to report to the court conduct or matters that are either contrary to the objectives of the statute or that unfairly prejudice particular stakeholders. The monitor's impartiality helps to ensure that unsecured and unsophisticated creditors are not "run over roughshod". In turn, the courts, creditors and the debtor company need to understand the importance of this balancing role for the monitor.

One view was that monitors' reports could be more robust, in terms of disclosing to the court where parties are engaged in misconduct during negotiations for the plan of arrangement. However, another participant pointed out that absent an express obligation to negotiate in good faith, such reporting is unlikely to have an effect on the timeliness or integrity of plan development.

The 2009 amendments to the *CCAA* codified much of the prior practice of monitors, in a sense creating greater transparency regarding the role of the monitor for parties that are not repeat players. Arguably, the provisions also give the monitor much more authority to maintain its impartiality as a court-appointed officer. Participants at the public meetings discussed whether or not there are still issues that remain where the monitor is asked to help devise the proposed plan and becomes too vested in the debtor's survival. One concern was whether a monitor can truly be objective or impartial under such circumstances, and there was no consensus on this issue during the public discussions.

i. The Debtor Should Lead the Evidence, Not the Monitor

There have been some issues regarding the monitor essentially leading evidence through its written or oral reports to the court. Many participants observed that the evidence should not be introduced through the monitor. The company debtor should introduce the evidence and then it can be properly subject to cross-examination. The monitor is then left to be the neutral assessor of the information.

In British Columbia, cross-examining the monitor doesn't happen because the courts will not allow it. Hence, monitors introducing facts into evidence can be highly problematic, as there is no opportunity to cross-examine the source of the evidence, the debtor's officers, and the debtor company is not held to account through normal evidentiary rules. Even the questioning allowed of monitors in Québec does not get around the issue of whether the parties that are being asked to accept the evidence as "fact" have an opportunity to test its veracity. Moreover, where the particular judge is not accustomed to oversight in *CCAA* proceedings, he or she may unduly rely on the information provided by the monitor as uncontested "facts", without the rigour applied to sworn affidavits or evidence under oath or affirmation. Yet, opening up the monitor to the prospect of cross-examination may adversely impact the leverage that monitors have in helping to drive a consensual resolution in all aspects of the restructuring, as creditors may wait to fight it out in court. This concern is alleviated where the debtor is required to introduce the facts.

There are circumstances where the monitor should weigh in with its professional views, even where the duties are not codified in the *CCAA*. For example, the monitor can offer a helpful opinion on motions for financing or other early process issues where the court does not yet have familiarity with the file. The monitor is also best placed to advise the court whether the timing and scope of notice of particular motions or actions is appropriate in the circumstances. The monitor can advise on the integrity of a process within the proceeding, such as a claims process or sales process, and in some instances it may have expertise in actual marketing and sales of assets. Participants at the meetings noted, however, that the court needs to be aware of the strengths and limitations of the particular insolvency professional, and some of the more specialized skills may not be possessed by all monitors.

ii. The Monitor as Financial or Business Advisor

For larger *CCAA* files, there is often a separation of financial advisors and the monitor, and thus issues of impartiality or conflicts of interest arise less frequently. Large or complex cases commonly have a separate investment banking advisor independent from the monitor. Even if a separate financial advisor is not present, the monitor can and does utilize its credibility and influence with the debtor to drive a solution that is best for, and has the best chance of, being supported by all the stakeholders.

There are other cases where the financial advisor has unilaterally determined that the monitor role needs to be separated, where there is a real or potential conflict of interest, and an independent firm is brought in to act as "skinny monitor". However, practitioners suggested that this latter structure is not enacted in certain cases where it perhaps should be, nor is it necessary or economical to do it in many other proceedings, given the size and resources of the debtor company. There was some discussion at the meetings about addressing this issue by having two monitors, one initially appointed on application of the debtor, to assist the debtor through the process, and one independent party as advisor to the court. However, it was felt that early days are critically important in many cases and the addition of second monitor, particularly in those many cases where it would not be warranted, could slow down a process that is often vitally dependent on speed. Moreover, the view was that such a strategy would add substantially more costs to the proceeding.

For smaller or mid-market files, monitors often provide guidance to the debtor company, given that it is more efficient and less costly; and the monitor already has credibility with the debtor and knowledge of its structure and operations such that it can help facilitate a solution. In respect of mid-market debtor companies, the administrative costs of a separate financial advisor may not be feasible. In some instances, the issue is whether the *CCAA* is the appropriate vehicle through which to restructure. At the very least, the court and other stakeholders should be expressly advised that the monitor has acted as a financial advisor to the debtor pre-filing.

The conduct of monitors is already subject to considerable scrutiny, under the obligation to act honestly and in good faith; through OSB oversight; requirements of the professional code of conduct; and the court's ability to replace the monitor.[91] Participants at the public meetings discussed whether or not anything else was needed.

- [91] Pursuant to Section 11.7(3), *CCAA,* the court may replace a monitor on application by a creditor.

In Vancouver, there was a lengthy discussion about increasing the powers of receivers within *CCAA* proceedings. For example, if creditors want the management out and the business to continue, receivership skills may be the more appropriate role for the insolvency professional, yet the monitor, within a *CCAA* proceeding, has insufficient authority to realize such a strategy. Several practitioners suggested that there could be a mechanism that allows the creditors to approve the monitor taking control. Particularly in cases where senior lenders have already granted and waited under a forbearance agreement, there should be mechanisms that prevent debtors causing delay in the *CCAA* proceeding. An example discussed at the Vancouver meeting was the Bear Mountain case, which several participants felt should have been a receivership.[92] It went through the *CCAA* proceedings, even though it didn't quite fit the framework; and one question was whether or not there should be some point specified in the statute or articulated in criteria by the court that indicates when a file should go into receivership.

One practitioner suggested considering the framework of the *Winding-up and Restructuring Act,* in the sense of when the debtor files, the management loses its capacity to manage. He suggested that there has often been a long period of forbearance prior to the *CCAA* proceedings, and in such cases, one option could be that management loses its role.

In terms of timeframes, participants at each of the meetings observed that parties need money to have a real look at the business to see if there is a solution and it takes about four to five weeks. The court will usually grant DIP financing order to keep the lights on and cover the monitor's fees. However, lenders in some instances don't like this tendency, because they have already made up their mind and have potentially spent money on something like a "look see" regarding potential for sale or workout. An underlying theme is the confidence of management, and whether any effort of the monitor is likely to remedy governance issues that may exist.

In Vancouver, participants observed that in real estate cases, the lenders usually know a great deal about the file, so they don't necessarily see any of the new solutions that could be available under a *CCAA* proceeding. They don't see added value, just the added costs of the proceedings. In several participants' views, often appraisals don't reflect reality, and the monitor needs to be more proactive in bringing valuation process deficiencies to the court's and creditors' attention.

[92] Bear Mountain, *supra* note 12.

Others in Calgary and Vancouver observed that there needs to be a focus on the underlying business substance and often the monitor does not have the particular business expertise to help, so it may be that a more rigorous selection process is required for the workout professional. One participant suggested importing some criteria from other statutes into this framework.

The majority of participants observed that the increase in out-of-court restructuring is a positive development, particularly where an insolvency or turnaround professional has been engaged. If parties are bargaining in the shadows of the statute, it means the market is working. Yet while many issues get resolved in such processes, there is remaining uncertainty. Moreover, if parties negotiate or avoid an insolvency filing for long enough, they end up polarized and creditors lose confidence. Absent a court process, there is no monitor to serve as an accountability check on the integrity of the workout process.

Practitioners in a number of cities suggested that businesses fail because of poor management, however, monitors have trouble speaking poorly about management since they are retained by the management. Often the secured lenders want *CCAA* proceedings because they are going to get the most value, but a number of participants felt that there is not enough disclosure by the monitor as to the ability of pre-filing managers to achieve a better result under the *CCAA* than through a bankruptcy.

A number of participants suggested that ultimately, any expansion in the role of a monitor should likely be statutorily enacted to be effective, as neither creditors nor debtors will ask for it. Their view was that it would not necessarily mean that the monitor moves to a greater role right away, because the filing is a way to force some creditors to the negotiating table.

iii. Impartiality

The *CCAA* court appreciates the issues surrounding the integrity and independence of the monitor, and the need also for the "perception of independence". Even where impartiality is not an issue, the perception of a debtor / monitor alliance may detract from the confidence of stakeholders in the process.

One issue raised at the meetings in Halifax and Calgary was how the courts deploy the monitor. Participants observed that sometimes requested "fact finding" by the court turns into the monitor becoming a *de facto* proponent of particular issues. "Assistance" to the court and to the parties must be more clearly defined. In the *Air Canada* proceeding, two or three affidavits were sworn up front and every other application was based on the monitor's reports that weren't subject to cross-examination.[93]

A number of practitioners suggested that a monitor is in a more vulnerable position if it has done all its work beforehand. Usually a *CCAA* filing is the result of weeks and months of planning and discussions involving a prospective monitor. The monitor can become wed to its views before even having preliminary discussions with the creditors. Others suggested that if the debtor company is going to run out of money, it may need to accelerate the filing, and may press the pre-filing monitor to move quickly to endorse its strategy to the court before the prospective monitor can undertake appropriate due diligence.

The monitor's impartiality is one important factor for outside financiers. In Montréal, the multiple hats worn by monitors are recognized as necessary. The monitor needs to be impartial so that the financiers can really know the cause of the insolvency; as one lender put it: "bad luck, bad management or fraud". Participants in Montréal observed that the Québec insolvency community has evolved recently towards using these three classifications to discern the underlying causes of the debtor's financial distress.

One possible amendment suggested is that the court could appoint the monitor from a roster. The company would still pay the costs, but the court would be the one to choose the monitor from a pre-approved list of qualified monitors. At the same time, the company would have a restructuring officer, but being appointed by the court might help with the independence issue. Others at the public meetings really disagreed with the notion of a roster of monitors because it might favour solely repeat players.

Others in Montréal suggested that the monitor knows that it must be impartial, and the current system allows the monitor to be a buffer between the debtor, the creditors, and the court, a "rapprochement" of the parties. The code of ethics that the monitor must follow and the increased codification of the *CCAA* offer the necessary tools to the

[93] Air Canada, *supra* note 77.

monitor. The view was that in *Air Canada,* the monitor did a good job of guiding the debtor.[94]

Also, in Montréal, it was observed that there are more professionals involved in the larger restructurings. The US lenders have a tendency to force the debtor to have a financial advisor. If management is poor, then the existing lenders who are going to convert their debt to equity are going to insist on better management. One practitioner observed that the days when a monitor came to court with a three page report and asked the judge to trust it do not happen anymore. Creditors want to be confident that the debtor is going to be serious about restructuring and they want to be confident of the advice that they are being given by workout professionals.

A number of participants at the meetings observed that the court is concerned with issues such as how vulnerable creditors are being treated and whether the DIP financing is realistic, responsive to the situation, and not too prejudicial to stakeholders. There was discussion in three different cities that the monitor could be more impartial in its submissions regarding DIP financing, particularly its views as to the necessity of the quantum of funds sought and whether the proposed use is appropriate. Since the monitor has often brokered the DIP financing, it tends to be more of an advocate than a court officer in its submissions for approval. In reality, monitors are usually acting quite impartially in their reporting to the court. There are often no alternatives because the debtor cannot afford double the number of professionals, as the cost would likely make *CCAA* proceedings financially prohibitive for many companies.

A considerable number of participants at the public meetings expressed concern that DIP applications create a sense of false urgency and force everyone to concede the financing and power dynamics at the outset of the case, often exacerbated by the monitor aggressively advocating for the DIP financing. The reality is that the debtor company and professionals have been planning the filing for months and it is only urgent because they have waited so long to file. A number of participants suggested that the DIP financing discussion is too fast-paced and that there should be some reasonableness in timing, and that the monitor should be sensitive to that issue in its submissions to the court. The system is built to put pressure on the creditors, and parties need the information to determine what the value added will be.

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[94] *Ibid.*

One suggestion was to impose two weeks' notice on a DIP financing application, then debtor companies would file in a more timely manner, and monitor's opinions regarding the proposed DIP facility would be better informed and more likely to be impartial.

Another observation was that it may not be a question of the impartiality of the monitor, but rather, the monitor's willingness to be candid with the company as to its views about how the management wants to restructure their business. Other participants at the meetings observed that the situation then becomes complicated by parties buying swaps and hedging their risk, and the monitor is not aware of such hedging and offers its views without full information.

Most monitors take their jobs very seriously. It was observed that the monitor in most of the big *CCAA* proceedings is one of the big four accounting firms. It is the monitor's corporate interest to keep the creditors happy, as ultimately there must be a plan that is going to pass with two thirds creditors support. Moreover, senior creditors are repeat players, and monitors must consider the reputational effects of not being impartial. Others noted that monitors need also to be sensitive to the interests of non-repeat players if they are to be truly impartial.

One practitioner observed that there will always be some misbehaviour, it is unavoidable, and the market should take care of getting rid of unqualified insolvency professionals. He suggested that the court should not be afraid to let the market know when a monitor does a bad job, given that it must be confident of its court officer.

There was also considerable discussion regarding the role of the monitor in liquidating *CCAA* proceedings, in particular, where the monitor endorses a strategy that deprives creditors of a vote. In the Calpine proceedings in Alberta, there wasn't a creditor vote, which was highly contentious.[95] Some participants expressed concern that creditors and third parties aren't always listened to by the monitor.

Another issue identified was the increased incidence of unsecured creditors committees (UCC) complaining about the monitor, calling the judge to say they have not received reports or to complain that the monitor is not doing its job. Such criticisms are unfounded more often than not, but the additional accountability check adds costs. Others suggested that a UCC should not be a reliable measure of the monitor's work.

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[95] *Re Calpine Canada Energy Limited*, Court of Queen's Bench of Alberta, File #: 0501 17864, Alberta Court of Appeal, File #: 0701-0222-AC; 0701-0223-AC.

There have been several judgments by the courts both praising the monitor's impartiality in the face of aggressive creditors and criticising the monitor's failure to maintain an impartial role. One participant observed that the problem with creditors being too ambitious on the first day applies to monitors as well. It has the potential to bring the insolvency system into disrepute.

iv. Pre-filing Monitor Reports

Pre-filing monitor reports were viewed by many across Canada as often too complicated and too expensive. The concern was that they can be used by the monitor or the debtor company to get decisions from the court before creditors have a chance to consider their positions or before they have sufficient disclosure.

One view was that an outcome of giving the monitor its relatively new statutorily imposed powers is that the debtor company is going to shop around more and find its preferred professional, because that selection happens several weeks before the filing. Pre-filing monitors can be easily discharged, which can create problems for the integrity or perceived integrity of a pre-filing report.

Most debtor companies have an idea about their initial cash needs, and most are transparent about these needs with secured creditors. However, practically, they don't want all the company's stakeholders to know that there is going to be a *CCAA* filing. If the debtor is three weeks away from a filing, the monitor will be restricted to the number and type of staff that it is allowed to solicit information or views from, which may skew the financial and operation information, in turn resulting in the monitor adopting a position that it is then difficult to back away from. The monitor does not get to speak to third parties to complete its pre-filing report because everything is staying quiet.

In terms of pre-filing disclosure and the impartiality of the monitor, one consideration is the ownership structure of the business. Some firms have very open ownership structures and it is easy to follow financial decisions, but others are very closed and the pre-filing monitor has limited access to material information. The impartiality of the monitor is much more assured in some companies than in others. The monitor wants to be working with the debtor ahead of time as it is important not to make an application without having some idea of how parties are going to get to the end of the process. That often involves the monitor looking at the business. Yet a number of practitioners

observed that there is a significant difference between working with the debtor and the monitor signing its name to a report where it does not have the protection of the court. Another concern about pre-filing reports is that prospective monitors really do not know the business until they work with the court and get instructions from and work with the debtor. It was also suggested that boiler plate pre-filing reports are not desirable either.

One disadvantage of the pre-filing report is that the monitor frequently signs off on a document without any consultation with the major players in the proceeding. In one case, a creditor wanted the monitor to consider receivership versus *CCAA,* and the monitor was able to take the creditors' opinion into consideration before filing its first report. Pre-filing reports may mean that the monitor will not switch its position, or the monitor will change its opinion but then must advise the court that it did not have sufficient information on which to base its initial position.

Another view was that it does not seem to be impossible for a prospective monitor to be talking to more stakeholders than just the company if it is investigating in anticipation of a *CCAA* file. Others disagreed, suggesting that the prospective monitor could not get a balanced view by speaking only with creditors privy to the debtor's financial distress, and that the debtor is likely unwilling to let it speak to any other creditors in advance of filing.

For many companies, all the information is public regarding bond payments they are making and other financial liabilities. The secured creditors often know that the debtor is in financial difficulty. A number of practitioners suggested that there should be more onus on the monitor to present to the court a very detailed, meaningful, monitor's report at the come-back hearing, rather than at the initial hearing, understanding that there are these initial limitations in access to personnel and information.

One member of the judiciary at one of the western Canada public meetings observed that the courts have generally expressed the view that pre-filing reports by the monitor should be the exception rather than the rule. In Manitoba, parties have used pre-filing monitor's reports because the Manitoba courts tend to be less familiar with the *CCAA* process. The courts have found them helpful in getting a read on the case; however, the view was that they ought not to be the routine.

The Ontario court has now expressed a view that it only wants pre-filing monitor reports in exceptional cases. There is tension around impartiality being compromised or at least having the appearance of such because of the engagement before the pre-monitor

report. Once the court has appointed the monitor, then a monitor's report could be generated much earlier than at the end of the initial stay period of thirty days.

In Toronto, practitioners observed that there are some things that the court is expecting out of a proposed monitor on day one. The monitor is usually right in the thick of things even though it does not yet have the court's endorsement. A number of participants agreed that the monitor should act like a monitor before it is appointed, but in reality, the proposed monitor can be pushed around more by the debtor company. Depending on the competition for engagements, monitors many be less likely to speak up to the debtor. A revised system where less happens on the first day would largely address issues regarding both pre-filing reports and the monitor's capacity to offer an impartial view at the initial hearing, because the monitor would have the court's protection before it commenced presenting its views to the court, leaving the monitor less vulnerable to pressure.

Others suggested that there has to be a realistic amount of time before the monitor can report and that a monitor's report two hours after its appointment is no different than a pre-filing report, as the information has been gathered before appointment and before the professional has full access to information; the same dynamics of debtor pressure would apply.

Several participants at the public meetings suggested that pre-filing reports can mean a professional is in the debtor company earlier and there is a possible linkage between the creditors and the debtor. Some Ontario practitioners view pre-filing reports as an important piece of evidence, but that was not the view in Alberta. A pre-filing report may be needed if a large DIP facility is sought on day one.

One practitioner observed that there was an Ontario *CCAA* file with fraud by management; inventory was missing. The monitor's signature would have been on a report that was completely inaccurate. In another major cross-border case, it was noted that the pre-filing report was essentially a signing off on the company's affidavits. At the come-back hearing at thirty days, the monitor reported that it had found something totally different. Hence, there was the view in most cities that absent exceptional circumstances, such reports should not become the norm because of both real and perceived independence and accuracy issues.

Another practitioner's suggestion was to adopt the mechanisms used by proposed trustees, in that instead of a pre-filing report, there should be a requirement of a proper monitor's report within a very short time frame. But others pointed out that such a sequence works better for *BIA* proposal files, because they are less complex and there may be fewer opportunities to miss important information.

An issue identified in Calgary, Toronto and Vancouver was in respect of monitors signing off on affidavits. By signing the pre-monitor report as an affidavit, to the extent that the pre-appointed monitor is relying on someone else, it can say so. But if the proposed monitor is not prepared to swear to it and there is not yet a court officer with separate obligation, the report should not be placed in front of the court absent some party swearing to it. One participant observed that with Bre-X, the initial insolvency professional was fired because it came across some shredded documents.[96] The debtor company should be making the affidavit, and the officers can then be cross-examined.

v. Practice Issues

The meetings across Canada generated a number of examples and instances where the practice of monitors or demands made on monitors have resulted in challenges to the monitor fulfilling its statutory mandate.

One practice suggestion was requiring the signature of an actual person on the monitor's reports, rather than the name of the monitors' firm. Firm names are not sufficient, and in one Alberta case, the judge indicated the need for an actual person to sign off.

A practice issue that came up at all the meetings was the question of at what point the monitor should report on management credibility and ability. If management cannot manage effectively, then one might question the utility of the process. A strongly held view was that the monitor should be at liberty to say the business is dead at the outset, but it is unlikely that the monitor will receive the engagement if it expresses that view.

One query was whether the monitor has the skill-set to judge management. Financial distress is not always attributable to poor management, particularly in the years since the financial crisis. The view was that, in some instances, the monitor is able to comment on something specific that can be addressed; for example, the debtor has weak financial staff or is missing some skills on the team. The monitor could be more explicit in some

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[96] *Re Bre-X Minerals Ltd. (Trustee of),* 1998 ABQB 1083 (Canlii), 168 DLR (4th) 215.

cases regarding the challenges of the underlying business, the capital structure, and the specific market.

Participants suggested that perhaps the monitor could provide an opinion to the court on the propriety of the debtor company being in the *CCAA* proceedings as opposed to accessing other mechanisms. To date, the focus has been on whether the debtor company and its officers are acting in good faith, but the monitor is not asked about the capability of management.

In Québec, it was noted that cross-examination of monitors was the exception rather than the rule, usually when the impartiality of the monitor is questioned. However, others pointed out that the monitor is cross-examined with some frequency in Québec to clarify certain questions. Generally, Canadian courts are reluctant to allow cross-examination of the monitor. One suggestion was that the model order could be amended so that the monitor's report need not be in affidavit form. Written interrogatories in Québec are viewed as working very well and are cost effective. In most files, parties find that they can call up the monitor and get clarification of issues or get disclosure on particular financial points, and it is only in the rare case that the monitor is not cooperative in meeting such requests.

One Alberta practitioner noted that typically the monitor's report has three layers in terms of what's in the report. It is based on a lot of work done by people who are at a more junior or even medium level. The person who signs it has a good idea of what is going on, but he or she does not necessarily have the knowledge to swear or affirm each point. Some participants suggested that thus actual practical difficulty is why the written interrogatory makes more sense than direct questioning. One can go back to the staff who actually put each point together to inquire about the underlying documentation, which is more sensible and cost effective and also ensures a better answer.

There was one occasion where the senior creditors were very critical of the monitor, and one party had asked to cross-examine the monitor. The monitor agreed to meet with the creditors to answer any interrogatories. The party turned it down and asked to cross-examine the monitor instead; but the court said no.

In *Canadian Airlines,* parties asked for cross-examination of the monitor on the issue of the valuation of assets that were part of the sales process.[97] At that point in the

[97] *Re Canadian Airlines Corp.*, Court of Queen's Bench of Alberta, File #: 0001-05071.

proceeding, there were affidavits that the parties could cross examine on, but the situation was highly litigious, and written interrogatories were less than satisfying. Several practitioners pointed out the difference between written and cross examination is that it is never the first question a party asks that gets the answer it is looking for. The suggestion was that there should be someone else from the debtor or other party that is proposing a particular action that has to file an affidavit and get cross-examined on contested aspects, rather than have the information in the monitor's report.

One suggestion in Vancouver was that perhaps there should be pre-filing standards of conduct entrenched in the statute so there can be discipline if things go wrong at the outset of the proceeding or shortly thereafter. Secured creditors expressed concern about the cost, and if creditors know the business more than anyone, they may want a relatively short fixed period to determine and advise the monitor if there is a potential workout. If the business is doomed to fail, they may support the monitor to say that after six weeks it should be in receivership. Participants observed that creditors get frustrated when the process lasts eight months and then goes into receivership, when it was clear almost from the outset that a workout was not possible, yet the monitor has not disclosed that situation to the court.

Another practice suggestion was the idea of creating standards for the come-back report, particularly operational or financial changes that must occur. Such standards would have to be codified because the creditors won't ask for it, because they would be asked to pay for it. The debtor companies will not ask for it because it creates more work for them. Sometimes there is really good operational management, but they are not able to navigate a restructuring. One practitioner suggested that the requirement could be that the monitor assesses all things, including management, and whether there is a prospect of restructuring that is realistic. The monitor could produce a solutions oriented report that is both retrospective and prospective. The advisor role could be augmented by a report from the manager who deals with all the operational decisions while the restructuring is going on.

Practically, the monitor and the creditors have to monitor management month by month, including assessing how budgets are being implemented. The assessment of restructuring potential might be a one-time event, but managerial success is an ongoing assessment. Most firms bring in specialists, and if the debtor proposes a good business solution, creditors will listen.

Another issue was post-filing expenses and the costs that accumulate in a proceeding that ultimately fails. Although it does not occur frequently, some concerns were expressed about the costs. In *Smokey River,* participants observed that there was a post-petition creditor charge, but it didn't fully compensate those who were involved in the *CCAA* process, they received only 75 cents on the dollar.[98] While all creditors take some risks, there was interest in "getting out in front of the issue" and making sure the monitor is focused on what is incurred and how it will be paid when there are post-filing creditors who are not getting paid.

Another practitioner noted that files would be better off if one could clear away some of the litigation aspects and get to the heart of some of the business issues; and that monitors could play a more robust role in facilitating such a change in focus.

vi. Monitors and Environmental Issues

A number of participants in Vancouver, Calgary and Montréal observed that there is growing competition between federal bankruptcy and insolvency laws and provincial environmental laws, and the role of the monitor in such disputes is becoming an issue. The most recent case is engaging the Newfoundland and Labrador court, but many provinces are getting involved and their Attorneys General have been given notice of constitutional questions. Concern was raised regarding the monitor seeking to be an intervener, becoming more like a party to a proceeding than an impartial court officer.

Rather than having the monitor become a party, the court could seek the views of the monitor, in its impartial capacity as officer of the court. Such an approach would remove pressure on the monitor by debtor companies and creditors to take an advocacy role in proceedings on environmental and similarly contested issues. If there really is need for specialized expertise to give a view to the court, then the debtor and creditors should agree to pay for that expertise, rather than push the monitor to act as intervener.

vii. Initial Suggestions for Change

1. *Pre-filing monitor's reports should be the exception rather than the rule, and the courts should develop clear criteria as to when they will be accepted.*

[98] *Re Smoky River Coal Ltd.*, Court of Queen's Bench of Alberta, File #: 9801-10214.

2. *Where pre-filing reports are used, the monitor should not introduce facts that should be adduced in evidence by the debtor company.*

3. *Pre-filing reports, where they are used, should specify, as a red flag, any consultation with creditors, and if not, specify that the monitor is basing its view solely on the debtor's information.*

4. *Where the monitor has acted as financial advisor to the debtor company pre-filing, that information should be disclosed to the creditors and the court at the outset of the proceeding.*

5. *The monitor should be authorized or required to provide an opinion to the court as to the propriety of the debtor company being in CCAA proceedings.*

6. *Consider implementing statutory language whereby the monitor is expressly required to offer its opinion on the quality of the existing management and its capacity to stay in control during the CCAA proceeding.*

7. *Consider codifying that the monitor cannot be a party or intervener to proceedings or appeals, but acknowledge that the court or the appellate court can request the monitor's opinion on one or more issues as an impartial court officer.*

8. *Consider developing either statutory language or a template monitor's report for the initial come back hearing, requiring the monitor to articulate the particular challenges facing the debtor company, the market conditions, outstanding obligations, and the realistic prospect, or not, of the debtor company restructuring within the CCAA proceeding.*

8. Treatment of Third Party Liability Waivers Under the *CCAA*

A compromise under the *CCAA* is generally between a debtor company and its creditors.[99] If the compromise is accepted by creditors and approved by the court, it is binding on creditors and on the company.[100] The compromise does not release certain liabilities that are similar in nature to those described in section 178 of the *BIA*.[101] The

[99] Sections 4, 5, *CCAA.*
[100] Section 6, *CCAA.*
[101] Section 19(2), *CCAA.*

provisions of the *BIA* and *CCAA* are substantially the same as regard the effect of court sanction of a proposal or a plan of arrangement, except that the prohibitions found at sections 62 and 179 of the *BIA* do not exist in the *CCAA*. While there is no explicit prohibition, there is also no specific authority to deal with third party claims other than the claims for the statutory liability of directors. The compromise is between a company and its creditors, and the court sanction is intended to compel the company and its creditors, not third parties.

However, the practice has evolved very differently in recent years, with the court finding that it has the authority to compel the implementation of a release of the claims against third parties as part of the compromise. It may always be possible to release third parties if the releasing party specifically agrees; however, the likelihood of this consent occurring is remote, as what is of particular interest in the *CCAA* is not a private agreement with one party, but rather the ability to force the minority to accept the wishes of the majority by compelling a settlement.

The difference in treatment between the two statutes has not always been present. The question of discharge of a third party was considered in 1993 in *Steinberg Inc. v. Michaud,* where the Québec Court of Appeal unanimously refused to approve a provision of the plan that called for a release of the claims against directors and officers.[102] Marie Deschamps JCA (as she then was) held that: “The *Act* and the case law clearly do not permit extending the application of an arrangement to persons other than the respondent and its creditors and, consequently, the plan should not have been sanctioned as is; however, in the instant case, this clause is considered as departing from the *Act.*”[103] However, the 1997 amendments to the *CCAA* and *BIA* provided for the possibility of a release of the statutory liability of directors or officers. That change was intended to encourage directors to remain when a debtor company was undertaking a restructuring process. The amendments were viewed favourably by restructuring professionals as a means to retain talented administrators.[104]

Under the *CCAA,* claims against directors are to be released only in limited circumstances, and the statutory language expressly excludes contractual liabilities such as personal guarantees and claims based on allegations of misrepresentation or wrongful

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[102] *Steinberg Inc. v. Michaud*, 1993 CarswellQue 2055.
[103] *Ibid.* at paras. 58, 60.
[104] Jean-Daniel Breton, “Reorganizations: Objectives Contemplated and Achieved by Legislative Changes Since 1992”, *Annual Review of Insolvency Law, 2002* (Toronto: Carswell, 2003), at 317-321.

or oppressive conduct. Thus the treatment is different depending on the impugned conduct and whether the third party to be released is a director or another third party.[105]

Since the early 1990s, with shifts in bargaining power and in the complexity of cases, the court has, in a number of cases, impinged on the rights of third parties. Examples cited by practitioners include a 1993 decision of Justice Farley in *Lehndorff General Partner Ltd*. to extend the stay of proceedings to creditors of a partnership, effectively preventing the creditors from enforcing payment against their debtor, the partnership, which the court found necessary to prevent the debtor company's assets from being dissipated, which would have it rendered the restructuring moot.[106] Justice Houlden in *Eaton Co*. refused to let tenants of shopping centres avail themselves of an anchor tenant clause in their lease to terminate a lease with a landlord in a shopping centre in which the debtor company Eaton was allowed to terminate its own lease,[107] effectively preventing third party tenants from asserting a claim against third party landlords in respect of Eaton's activities. The rationale was the concern that Eaton's compromise may not be approved by landlords if the other tenants were allowed to avail themselves of the anchor tenant default provision of their lease.

The next significant shift involved the proceedings in *Muscletech Research & Development Inc*., in which the Court found that it was fair and reasonable to effect a release of third parties, as the fund from which the settlement would be paid was being contributed by these third parties, and there would therefore not be any plan unless and until the releases were provided.[108] Justice Ground found that the release was not only fair and reasonable, but he concluded that it was essential in the context of the particular plan. The case involved multiple levels of potential claims relating to product liability, and it was thought that it would be impossible to deal with all of the claims without dealing with the third parties who could also be liable, and who were prepared to contribute funds to a settlement but only if their own risk was settled by the process. In *Hy Bloom*, the Court held that the release of a third party in the context of an arrangement should be done only where there are special circumstances warranting the exclusion of a remedy against a third party.[109]

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[105] Also whether the proceedings are taken under the *BIA* or *CCAA.*
[106] *Re Lehndorff General Partner Ltd*., 1993 CarswellOnt 183.
[107] *Re T Eaton Co*., 1997 CarswellOnt 1914.
[108] *Muscletech Research & Development Inc*., 2007 CarswellOnt 1029.
[109] *Hy Bloom Inc v. Banque Nationale du Canada,* 2010 CarswellQue 11740, which reviews the criteria utilized by the courts for the approval of a release.

In *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp*, the concept of release of third parties was pushed even further, by requiring a very wide release for most participants in the Canadian asset-backed commercial paper (ABCP) market, with narrow exceptions for fraud and investigations by regulatory bodies.[110] The Court qualified the releases as a *quid pro quo* to compensate the participants for the contributions they would make to the restructuring, not by providing funding, but rather, by assuming higher risk, providing lower cost financing, etc. The releases were found by the Court to be necessary because key participants had made the comprehensive releases a condition of their participation. The proceedings in the ABCP file met with resistance from the creditor community because the releases would strip investors of their civil remedies under the rules of civil law.[111]

Based on the jurisprudence to date, the criteria for inclusion of a release appear to be the following. First, the release of a third party in a context of an arrangement must not be systematically accepted, but rather, there must be special circumstances warranting the exclusion of the remedy against a third party.[112] Second, the release must be reasonably connected to the restructuring, the connection being directly related to the workout. The court considers this approach not to be a “gap filling measure”, but rather, an interpretation of the *CCAA* statutory language that must be given liberal interpretation.[113] Third, the parties to be released must be necessary and essential to the restructuring of the debtor. Fourth is the requirement that the plan cannot succeed without the releases, and they are rationally related to the purpose of the plan. Fifth, the parties being released are contributing in a tangible and realistic way to the plan. Sixth, the plan must benefit not only the debtor company but creditors generally. Seventh, the voting creditors approved the plan with knowledge of the nature and effect of the releases. Finally, the court must be satisfied that in the circumstances, the releases are fair and reasonable in the sense that they are not overly broad and not offensive to public policy.

Arguably, the ABCP and Nortel releases were exceptional cases.[114] However, the courts are now seeing requests for release from third party liability as a matter of course. In most instances, they do not fit with the criteria set out in caselaw. Their contribution to the

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[110] *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.,* 2008 CarswellOnt 4811.
[111] One particular creditor, in addition to participating in an appeal of the order confirming the plan, requested that the Québec Superior Court refuse to apply the “foreign” judgment issued by the Ontario Superior Court of Justice.
[112] *Re Hy Bloom,* quoting re Charles Auguste Fortier Inc., 2008 CarswellQue 11376.
[113] *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.,* 2008 CarswellOnt 4811.
[114] Nortel, *supra*, note 6. In Nortel, as part of the settlement agreement, the representatives and their counsel were released; it was essential to the settlement. See also the *Grace* proceeding, an environmental liability case with eight class action cases against Grace; a settlement was reached with representative counsel, as they were essential to the deal.

workout is unclear, and there are not special circumstances existing that require such a release. One concern identified was that a release up front is a form of blank cheque that will create shirking behaviour. There may be a difference between granting a release during a proceeding versus at end of a proceeding to tidy up outstanding liability concerns.

Two issues raised by a number of participants in meetings were, first, that the ABCP judgment has created real pressure on some files, giving some potential defendants considerably more bargaining power within workout negotiations; and second, that the courts are not given viable alternatives to important compromises of claims, a number of practitioners suggesting that the courts may be too quick to accept the releases as essential to the workout.

i. Comparing Provisions Under the US *Bankruptcy Code*

The US *Bankruptcy Code* provides that confirmation of a plan binds the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.[115] It also provides that the confirmation of a plan operates as a discharge of the debtor.[116] §523 of the *Bankruptcy Code* provides exceptions to the discharge that are similar in nature to the exceptions listed in the *BIA*. §524 of the *Bankruptcy Code* specifies the effect of a discharge; that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." The only third parties that appear to be able to obtain a release are the debtor's spouse in certain circumstances,[117] and certain third parties in the context of asbestos related claims, when the court makes a supplementary injunction in the course of proceedings under Chapter 11.[118] Notwithstanding the fact that there appears to be limited possibility of obtaining third party releases, in practice, releases have been granted and widely construed, such as in the Quebecor case.[119] The US Court appears to have based its authority on the provisions of §105 (powers of the court i.e. the "judicial

[115] § 1141, US *Bankruptcy Code.*
[116] *Ibid.*
[117] § 524(a)(3), US *Bankruptcy Code.*
[118] § 524(g), US *Bankruptcy Code.*
[119] *Re Quebecor World Inc.,* Order of the Canadian Court approving the Plan at paragraph 18 and Order of the U.S. Court confirming the Plan at paragraph KK; accessible through http://documentcentre.ca.na.ey.net/default.aspx.

discretion" section), §1123 (contents of plan) and §1129 (confirmation of plan), and the fact that the releases were essential, were supported by valuable consideration, conferred material benefits, and were in the best interest of the debtors and creditors.

In the ABCP file, the US Bankruptcy Court made an order recognizing the Canadian proceedings and confirming the third party releases granted in the *CCAA* proceeding under s. 15 of the *Bankruptcy Code*, recognizing, however, that such a release would not generally be granted in a US proceeding. The US Court based its endorsement on comity and a finding that it was not manifestly contrary to US public policy. The Court suggested that a third party non-debtor release is proper only in rare cases, because "non-debtor release is a device that lends itself to abuse. By it, a non-debtor can shield itself from liability to third parties. In form, it is a release; in effect, it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the *Code.* The potential for abuse is heightened when releases afford blanket immunity."

A number of participants suggested that there could be codification in the *CCAA* to recognize that such releases should only occur in very exceptional circumstances, to avoid this risk of abuse.

ii. Initial Changes to Consider

1. *If the possibility of settling liability claims against third parties is to be retained, there should be rigorous criteria set out in the statute, including setting a high threshold for the granting of such releases.*

2. *Consider aligning the treatment of third party liability claims under the BIA and the CCAA, or if there is a compelling policy reason to distinguish the statutes, make that reason transparent to creditors and other stakeholders.*

3. *Consider creating statutory language that specifies which classes of third parties could be released under exceptional circumstance and clarifies that third party releases should be limited to the third parties that are addressed in the legislation.*

9. Challenges for Employee and Pension Claims

The current challenges for employee and pension claims in *CCAA* proceedings easily would warrant a separate set of public meetings and separate report. Participants stressed that they were only identifying the issues that require considerably more study. Overall, participants expressed concern that the employee and pension issues only receive attention in the heat of a file, and that there is a need for a more systematic analysis of principles and practices. Moreover, such a process needs to involve union counsel, pension and employment practitioners if there is truly going to be a balanced policy approach.

i. Representative Claimants in *CCAA* Proceedings

A number of *CCAA* proceedings have involved the court approving representative counsel for non-unionized employees, pensioners or long-term disability (LTD) claimants. Such representatives, usually paid out of the assets of the debtor, can ensure that disadvantaged creditors are appropriately represented and can ultimately assist in controlling transaction costs. Overall, there was broad support for the use of such representatives in the *CCAA* proceedings. However, there were issues identified, which relate to choice of representative claimant, and to potential conflicts where the representative claimant's interests clash with the interests of others represented in the group. There can also be governance issues in respect of directing representative counsel or communicating back to, and eliciting or representing the views of, the group represented.

Underlying these issues is who is affected by the *CCAA* proceeding and what is the purpose in seeking representative counsel. There was some concern expressed that current representation orders do not deal appropriately with games being played by individuals within the represented group. An important consideration is what the value being generated or protected through representation orders on behalf of employees, pensioners and other stakeholders. Generally, it was felt that representative counsel that were repeat players understand their role as an officer of the court and understand the need for balanced representation. However, there has been the occasional situation where representative counsel became the advocate for the representative claimant, not always concerned about other stakeholders in the group being represented.

ii. Priority of Wage, Benefit and Pension Claims

The most recent legislative amendments enhanced the priority of wage and pension claims under Canadian Insolvency Law. Still, internationally, Canada falls near the bottom of more than 60 countries in its protection of employees and pensioners on insolvency. Canada should consider further enhancement of the priorities granted.

The modest priority changes brought into force in 2008 were contested by some parties, primarily on the basis that credit markets would be negatively impacted. Yet comparison with similarly situated jurisdictions, with considerably more protections in place, suggests that credit availability has not been impacted in the way feared. All parties to *CCAA* proceedings are aware of concerns regarding changing priorities. Fear of credit loss is a fair consideration, but given the changing nature of the credit market, particularly where creditors have increasingly hedged against their potential losses, the priority granted to the most vulnerable stakeholders needs further consideration.

The challenge is how to protect the vulnerable while accomplishing other goals of the legislation. Employees, disabled employees and pensioners have no ability to hedge their risk of potential loss. A number of practitioners observed that we need to consider the nature of the process and how it can be responsive to the stress, hardship and emotional responses to loss of income and benefit support for individuals who have few alternatives to support themselves financially.

One question discussed was whether Canada should consider adopting the US approach that benefits continue to be paid to employees as an administrative expense during workout negotiations. It was recommended that Parliament devise a comprehensive approach to ongoing post-employment benefits (OPEB) such as basic health and medical coverage.

Another suggestion was that the statute be amended to create transitional protection regarding such benefits while the future of the company is being resolved. A further suggestion was statutory language to transition employees to other coverage, where possible. One participant observed that if the debtor company can make required wage and benefit payments to preserve the directors' liability position, it may ensure that the compensation owing gets paid to employees, and not detract from the incentives created by imposition of director liability for failure to meet such obligations. Of particular concern at a number of the public meetings was how *CCAA* proceedings can protect employees

during complex cross-border negotiations, where assets that would have been available to protect them are being diverted to meet the claims of creditors in related entities.

While there was a small minority of participants that disagreed, most participants at the public meetings across Canada thought that employees and pensioners should be better protected in the statute. Concern about special payments was more concern regarding the uncertainty of quantum than not wanting to comply with pension legislation. A number of comments were made about the failure of pension regulators to enforce at much earlier stages of the firm's productive life to address any pension deficits.

One practitioner suggested that the pension regulator should be given early intervention powers similar to regulators under the *Winding-Up and Restructuring Act* and given to the Office of the Superintendent of Financial Institutions, to use such authority where there is a risk of a pension deficit or solvency deficiency. Under *WURA*, there are multiple stages of intervention, but the goal is to emphasize to the debtor that it is failing in its statutory obligations and that there are consequences if it does not take steps to remedy the solvency or liquidity deficiency.

Another practitioner suggested that paramountcy issues could be addressed by simply amending the *BIA* and *CCAA* to recognize the deemed trusts contained in provincial pension statutes, taking the assets out of the estate and the priority contest in the *BIA*. One practitioner noted that if these trusts were recognized and respected, creditors will price credit accordingly, given that they take legal standards as they find them, and they will be more likely to monitor compliance as it could affect their claims.

iii. Retirees and Former Employees

One suggestion was that if there are going to be immediate hardship issues in terms of wages, benefits and/or pensions, a process should be fashioned to address these hardship issues early in the *CCAA* proceeding. Such processes can help those individuals most severely prejudiced by a loss of income or health benefits and can set a baseline of good will in the future negotiations.

In terms of creating processes to address financial hardship, there needs to be a mechanism to decide how to measure hardship, to determine who will decide who is eligible for relief, and the nature and extent of funding that will be allocated to such relief.

The monitor may have a role in oversight or monitoring of the hardship determination process.

In respect of any type of long term disability liability, there is a need to reduce uncertainty.[120] One option would be to legislatively prohibit self-funded and self-managed benefit and pension plans, such that funds would be set aside during the productive life of the debtor company and placed in trust to meet expected costs of LTD and other benefits and defined benefit pension plans.

Several practitioners suggested that the *BIA* and the *CCAA* should be amended to include as a priority claim the arrears of special payments, because they are overdue at the time of filing. Another suggestion was that when the court approves the initial stay under the *CCAA*, it should be required to consider the effect of halting special payments on the rights granted to continuing employees under section 11.01 of the *CCAA.*

With pension deficits and health benefits, there are potentially huge numbers of claimants and considerable cost involved. One issue raised was how payments continue during the *CCAA* process. There were a number of suggestions that it is timely to revisit the scope of priorities. For example, terminated employees are often the most adversely affected economically; and they are better protected under bankruptcy. Losing the job is a greater hardship than loss of the amount of the last pay cheque. Hence, one recommendation was to enact a provision creating priority for a capped amount of severance or termination pay, such as four weeks of wages. Another recommendation was to revisit the concept of an interim dividend for vulnerable claimants.

Overall, practitioners observed that there needs to be considerably more study of the exact challenges and hardships and how Parliament can devise a helpful public policy response that better protects employees, LTD recipients and pensioners and creates a better culture of cooperation.

One observation was that if a debtor is going to run a business, it must take on the risk of liability for its employees where it has offered pensions and benefits, just as it takes on the risk of secured debt where it has agreed to a loan. In both cases, the liability is contractual. Secured creditors need to better understand that liabilities incurred by the debtor company with various claimants should be treated as debts, whether they are sophisticated lenders or employee claimants.

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[120] See also the discussion at part v of this section.

One practitioner observed that there need to be mechanisms enacted that will allow pensioners to commute their pension amounts, whether the company is insolvent or not.

Another observation was that pension laws, labour laws and employment laws are all highly codified, and have evolved over the years to find the appropriate balance between the debtor company's right to manage and the protection of employees; and that insolvency law should be reluctant to intervene and oust those protections unless there is truly a conflict. Practitioners suggested that in a number of instances, the insolvency court is too quick to discount or find an operational conflict with provincial legislation, which then has a negative effect on the ability of unions and employee representative counsel to have a meaningful role in workout negotiations. Participants observed that unions understand that if the business is to continue in some form, it will have to make the deals.

iv. Considering the Implications of Indalex

The Ontario Court of Appeal rendered a judgment on the relationship between the deemed trust provisions of the *Pension Benefits Act (PBA),*[121] and DIP financing priority in *Re Indalex Limited*.[122] That judgment received leave to appeal to the Supreme Court of Canada, and a decision from that court is pending. The Court of Appeal held that the *PBA* contains a detailed statutory scheme that must be followed when a pension plan is to be wound up, which imposes obligations on the employer and plan administrator. Section 75(1)(a) requires the employer to make all payments that are due immediately or that have accrued and not been paid into the pension fund.[123] Section 57(4) deems an employer to hold in trust an amount equal to the contributions "accrued to the date of wind up but not yet due under the plan or regulations". The required contributions are the amounts that an employer must make to the pension fund so that the accrued pension

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[121] *Pension Benefits Act*, R.S.O. 1990, c. P.8.

[122] *Re Indalex Limited,* 2011 ONCA 265 (Ont. C.A.). An insolvent Canadian company's pension plans were underfunded and in the process of being wound up. The company was the administrator of the pension plans. The company obtained protection under the *CCAA*; and a court order enabled it to borrow funds pursuant to a debtor-in-possession (DIP) credit agreement. The order created a priority charge in favour of the DIP lenders. The obligation to repay the DIP lenders was guaranteed by the company's U.S. parent company. The company was sold through the *CCAA* proceeding, but the sale proceeds were insufficient to repay the DIP lenders. The U.S. parent company covered the shortfall, in accordance with its obligations under the guarantee. The *CCAA* monitor held some of the sale proceeds in a reserve fund and a dispute arose as to who had priority to the value of the reserve funds. The pension plan beneficiaries claimed the money based on the deemed trust provisions in the *Pension Benefits Act,* R.S.O. 1990, c. P.8 (*PBA*).

[123] Any unpaid current service costs and unpaid special payments are caught by this subsection. *Ibid.*

benefits of the plan members can be paid. The Court of Appeal held that s. 57(4), given its grammatical and ordinary meaning, contemplates that all amounts owing to the pension plan on wind up are subject to the deemed trust, even if those amounts are not yet due under the plan or regulations. Therefore, the deemed trust in s. 57(4) applies to all employer contributions that are required to be made pursuant to s. 75 and include, as per s. 57(4), all amounts owed by the employer on the wind-up of its pension plan. The Court held that this interpretation is consistent with the overall purpose of the *PBA*, which is to establish minimum standards, safeguard the rights of pension plan beneficiaries and ensure the solvency of pension plans so that pension promises will be fulfilled.

The Court of Appeal also held that the administrator of a pension plan is subject to fiduciary obligations in respect of the plan members and beneficiaries; these obligations arise both at common law and by virtue of s. 22 of the *PBA*, which expressly prohibits the administrator from knowingly permitting its interest to conflict with its duties in respect of the pension fund. The Court held that the debtor breached its fiduciary obligations as administrator during the *CCAA* proceedings. The debtor had the right to make the decision to commence *CCAA* proceedings wearing solely its corporate hat. That decision is not part of the administration of the pension plan or fund. However, the Court held that not all subsequent decisions made during *CCAA* proceedings are solely corporate ones. In the circumstances of this case, the debtor could not simply ignore its obligations as the plan administrator once it decided to seek *CCAA* protection. The decisions that it was unilaterally making had the potential to affect the plans beneficiaries' rights, at a time when they were particularly vulnerable.[124] Accordingly, the company was in breach of its fiduciary obligations as administrator and was in a conflict of interest position under s. 22(4) of the *PBA*. The assets that would flow to the parent corporation, absent the constructive trust, were directly connected to the process in which the debtor committed its breaches of fiduciary obligation. Without the proprietary remedy, the plans' beneficiaries would have no meaningful remedy. Moreover, the Court held that there must be some incentive to require employers who are also the administrators of their

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[124] The peculiar vulnerability of pension plan beneficiaries was even greater than in the ordinary course because they were given no notice of the *CCAA* proceedings, had no real knowledge of what was transpiring and had no power to ensure that their interests were even considered, much less protected, during the DIP negotiations. The debtor did nothing in the *CCAA* proceedings to fund the deficit in the underfunded Plans; it took no steps to protect the vested rights of the Plans' beneficiaries to continue to receive their full pension entitlements; and it took active steps that undermined the possibility of additional funding to the Plans. It obtained a *CCAA* order that gave priority to the DIP lenders over "statutory trusts" without notice to the Plans' beneficiaries. It sold its assets without making any provision for the Plans. It knew the purchaser was not taking over the Plans. It moved to obtain orders approving the sale and distributing the sale proceeds to the DIP lenders, knowing that no payment would be made to the underfunded Plans; and its parent corporation directed it to bring its bankruptcy motion with the intention of defeating the deemed trust claims.

pension plans to remain faithful to their duties; and because the parent company was not an arm's length innocent third party, imposing a constructive trust in favour of the plans' beneficiaries was not unjust.

The judgment raised some important questions as to how directors and officers of debtor companies should make decisions in respect of DIP financing and other activities, in light of their fiduciary obligations under pension legislation. While pension legislation appears clear, it was suggested that there should perhaps be statutory language in the *CCAA* to clarify pension protection. Toronto practitioners were concerned about certainty in the availability of DIP financing given the priority in judgments. Others, however, felt that the judgment navigated the complex interests implicated in insolvency and pension legislation.

One concern expressed in Toronto was that the parties with the resources to lobby Parliament or make submissions to the Supreme Court of Canada in the appeal in this case, are all insolvency practitioners, which may skew much needed public policy debate on the interests of pension beneficiaries.

The second issue is the salutary reminder from the Ontario Court of Appeal in *Indalex*.[125] When the plan has a deficit and the employer is insolvent when the company is administering the pension plan, the company ought to pay attention. What *Indalex* ends up saying is that if the plan had filed a winding up procedure before the corporation filed under the *CCAA*, counsel could have been retained and steps could have been taken by that plan.

Subsequent to this judgment, the Ontario Superior Court of Justice in *Timminco* confirmed that federal paramountcy can still be invoked where application of provincial pension benefits legislation would otherwise frustrate a company's ability to restructure and avoid bankruptcy.[126] The Court held that to the extent that the request for the DIP lender's priority charge was a request for the court to override the provisions of the *QSPPA* or the *PBA*, the court had the jurisdiction to grant the request. Practitioners expressed the view that lenders were more satisfied that the tests in *Indalex* and *Timminco* could be applied to balance the various interests in the proceedings.

[125] Indalex, *supra* note 122.
[126] *Re Timminco Ltd.* 2012 ONSC 948.

v. Disabled Employees

Disabled employees can be one the most vulnerable groups in an insolvency. In particular, employees on long-term disability (LTD) may have very little chance of recovery and usually cannot get another job to replace any lost income.[127] Disabled employees are also employees who are covered by other benefit plans/pension plans and may be entitled to severance pay, so potentially they will have other losses in addition to LTD benefits when their employer becomes insolvent. They will be disproportionately affected by the loss of drug plans and similar benefits because their medication costs may be very high. It is very hard for disabled employees to find replacement insurance. Depending on nature of their illness, it may also be difficult for disabled employees to participate in insolvency proceedings to advocate for what benefits they can be accorded in an insolvency situation, not to mention the delays they face in having costs covered. The situation is better if the employees are represented by a union, but more than 60% of the Canadian workforce is not unionized. Issues can be very complex and can create a very stressful situation for people who are already in bad health.

One practitioner in Toronto observed that every insolvency case is different. She suggested that first, if the LTD income benefits are insured with an outside insurance company, the least serious of potential scenarios, there are sometimes issues with employees who are in the process of qualifying for LTD. While the debtor company may still have to deal with all of the other issues, such as benefits, severance pay etc. for these employees, the employees should at least be guaranteed their income benefits. She observed that the other end of the spectrum is where the disability payments are "pay as you go". They are self-insured and there is no separate trust fund or pool of money to fund these benefits. In this case, the disabled employees' rights are limited to making a claim in the insolvency proceeding. Even though disabled employees are technically considered to be active employees, there is no special protection for them under wage earner protection laws or the *BIA.* Therefore, they must claim as unsecured creditors.

A scenario that often occurs is where there are self-insured LTD benefits where there is a trust fund. Although it is possible that the trust fund totally covers the benefits, it is more likely that the trust will be significantly underfunded, as the current tax regime does not encourage full funding. In such cases, the disabled employees can recover at least some

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[127] My thanks to Fiona Kelly for her assistance with this section.

of their benefits from the trust fund. However, this process is not necessarily easy or straightforward. The debtor, employee counsel and creditors have to undertake an analysis of the trust fund and the practices surrounding the payment of benefits from the trust fund. As in the case of Nortel, the trust fund may be used for multiple benefits, not just disability benefits. Then parties have to look at what benefits the trust fund is intended to cover and consider how to split it up. The process is further complicated by the fact that it is not clear what legal process should be used to deal with this issue and the fact that there may be conflicts between different groups of beneficiaries. In the Nortel example, the value of health and insurance benefits was over $500 million, but there was just $80 million in the trust fund. The value of the disability benefits alone was over $100 million. Dealing with just this issue in the Nortel proceeding has resulted in considerable litigation over the past year, culminating in the Supreme Court of Canada dismissing an application for leave to appeal. To the extent that the disabled employees are not able to collect from the trust, they are thrown back into the insolvency process to attempt to collect the rest of their claims as unsecured creditors.

Another issue, even if the trust is not underfunded, is whether the payments received from the trust fund are taxable in the employees' hands. Practitioners observed that it has been unclear and is sometimes necessary to get advance ruling from the Canada Revenue Agency.

Another concern raised was the issue of representation of disabled employees in insolvency proceedings. If a union is involved, it would normally represent the disabled employees. For non-union employees, representation orders are possible, with costs paid out of estate. However, approval of a representative order is not always an easy process for unions, representatives or legal counsel, particularly where there are conflicting views about how to pursue issues. With disabled employees, there are many different types of losses and the advocates of disabled employees often have to fight hard to receive disclosure and to have their voice heard in proceedings.

vi. Nurturing New Processes

One question raised was whether we should be dealing with pension and long-term disability issues in insolvency policy or in social policy. Economic promises to employees do cost money and there was broad consensus that pension and other promises can affect the cost and, in some cases, the availability of credit. It was suggested, however, that we simply recognize these issues and then have the social policy discussion as to

why Canada falls at the bottom of most developed countries in its protection of employees on insolvency. Some other countries don't use their insolvency legislation to protect their employees, but they have strong pension and employee protections that trump insolvency legislation, providing clarity for parties. Canada's overall scheme provides less protection for employees than other countries, and participants suggested that perhaps Canada should consider a broader approach. The challenge is to assist employees in a way that does not affect the credit markets too much. The *Wage Earner Protection Program* (*WEPPA)* was a first effort, but more is needed.

Many monitors observed that if it is a vulnerable, unorganized group, then they will make a special effort to ensure that wage and pension issues are resolved early in the proceeding. It was suggested that in small files, the monitor often fulfills the role of representative counsel and ends up counselling employees.

A number of participants suggested that the Canadian government could learn a great deal from the recovery efforts of the pension guarantees fund in the UK and the US. The UK Pension Protection Fund has managed to recoup much of its value that it pays out because it is such an aggressive creditor. Both the UK Pension Protection Fund and the US Pension Benefit Guarantee Fund take over assets of a debtor, where necessary, to meet the pension promise. In some instances, they have recovered through acquisitions of real property in the sale or settlement of the debtor's assets. Often a significant claimant, the guarantee funds will bargain for recovery and will take debtor equity in consideration for outstanding liabilities.

At a number of meetings, it was suggested that a national pension guarantee fund in Canada would be most appropriate means of addressing current pension deficits, although it would be challenging to achieve given Canada's Constitutional division of powers. Then such an authority would have muscle in insolvency negotiations as it could represent all affected employees instead of the "divide and conquer" dynamics that occur now with disparate regulatory authorities. It was suggested that such a strategy could be coupled with amendments to insolvency legislation to protect pension assets by "ring fencing" them out of the reach of other creditors, just as some forms of secured credit do.

Another suggestion was to amend provincial pension statutes to prohibit "pension holidays", which would better protect employees and also force the debtor company to deal with problems earlier in its deteriorating financial health, ultimately protecting creditors better.

One participant noted that there is an economic policy dimension. In *Algoma Steel*, he observed that the monitor was trying to protect people who were earning two to three times that earned by workers in some other sectors. He argued that the *CCAA* can be used for economic adjustment. Others argued that there needs to be awareness that there are wage differentials that are historically driven, and that these negotiated wages and benefits need to be respected.

Another practitioner observed that Canadian legislation has related employer provisions for everything except pensions, and that perhaps it was time to consider such provisions, which would address issues both in and outside of insolvency.

Many participants at the meetings observed that the days of debtors and senior secured creditors ignoring employees and pensioners have passed. Courts are now sensitive to the need to consider all stakeholder interests. Hence, it is timely to think about processes that nurture forward looking negotiations. That includes appropriate and timely notice of proceedings to unions, pensioners and employees. Early in the process, the debtor should identify leaders in the appropriate employee, union, and pensioner groups. Unions are generally accountable to large memberships, including democratically set policies at union conventions as to how they will approach insolvency negotiations; hence debtors, creditors and insolvency practitioners need to understand this background and process.

In nurturing new processes, parties need to understand the perception gap between what unions and employees see as generous key employee retention plans (KERP) and key employee incentive plans (KEIP) for senior managers and the losses that they are being asked to suffer through forbearance on wages, benefits and pension claims or in job losses. Moreover, there are serious concerns that KERP and KEIP established early in a *CCAA* proceeding are not properly monitored or accountable in terms of continuing or accelerating costs, creating unfairness between managers and other employees.

vii. Initial Changes to Consider

1. *Consider adopting statutory language that benefits continue to be paid to employees as an administrative expense during workout negotiations.*

2. *Consider statutory language to transition employees to other benefits coverage, where possible.*

3. *Include long-term disability benefits under the limited wage priorities granted in the BIA.*

4. *Consider enhancing wage, benefit and pension priorities to align with a number of other OECD jurisdictions.*

5. *Consider asking Parliament to devise a comprehensive approach to ongoing post-employment benefits (OPEB) such as basic health and medical coverage, creating transitional protection of such benefits during the period that the future of the company is being resolved.*

6. *The BIA and the CCAA should be amended to include as a priority claim the arrears of special payments, because they are overdue at the time of filing.*

7. *Consider amending the CCAA to require the court, when it approves the initial stay order, to consider the effect of halting special payments on the rights granted to continuing employees under section 11.01 of the CCAA.*

8. *Prohibit, by statute, self-funded and self-managed benefit and pension plans.*

9. *Consider implementing a hardship provision that would give employees and pensioners immediate financial relief in particular circumstances.*

10. *Consider enacting a provision that creates priority for a capped amount of severance or termination pay, such as four weeks of wages.*

11. *Consider enacting an interim dividend for vulnerable claimants.*

12. *Consider codifying the findings in the Indalex Court of Appeal judgment to create certainty in respect of the obligations of a debtor company and its directors and officer where the debtor company is the pension plan administrator.*[128]

13. *Consider creating particular thresholds for the granting of KERP or KEIP, with codified criteria, greater transparency of the benefits and incentives being given,*

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[128] *Ibid.*

and requiring enhanced monitoring and evaluation of the continued need for resources to be directed towards these officers or employees.

10. Accountability of Directors and Officers

Many participants at the meetings across Canada suggested that there is an absence of accountability of the debtor company and its directors, officers, and others who may have aided in the failure of the business. On the one hand, Canadian public policy understands the important of offering indemnification to directors where it is helpful to have their information, skills and experience to assist in development of a plan. On the other hand, the anticipated protection may encourage shirking and lack of accountability of such officers in the period leading up to and during insolvency.

The general consensus was that most directors and officers are interested in helping the business to survive, although they may not have the skills or experience to discern the way forward when the company is experiencing financial crisis. They are highly reliant on their insolvency, financial and legal advisors for advice. The liability fear, while legitimate, is not borne out by the cases finding director and officer liability. However, creditors use such potential remedies during behind the scenes negotiations as a non-veiled threat to the directors and officers, pressing for a bargaining advantage over other creditors. If a decision is an honest business judgment, directors and officers are generally not held liable, even if the decision turned out badly. The issue is whether they acted in the best interests of the company, based on the information and investigation they undertook at the time of the decision.

Where there may have been culpable behaviour, there is a live question as to who might bring a complaint forward, and thus the liability risk is somewhat limited. Stakeholders are collaterally affected, but they may not pursue remedies, given the costs of pursuing such claims. They are more likely to take their losses based on a practical commercial decision.

The increase in key employee retention plans (KERP) are often driven by managers seeking returns to stay and offer informational capital in the workout. There is an element of what is fair compensation in terms of retention pay and benefits, and what is inappropriate given the insolvency of the company. Some practitioners have observed that benefits sought under KERP are increasingly managers seeking to blackmail

creditors and the insolvency professionals, creating an imbalance in the allocation of costs and benefits during the proceeding.

One view was that there could be liability consequences attached to directors and officers proposing KERP, as a form of accountability check on the real need for, and fairness of, this special compensation. Coupled with greater monitoring of the continuing need for such costs, discussed in Part 9 (vi) above, it is more likely that KERP would be used more appropriately.

Finally, a number of participants noted that there is an increase in applications for an oppression remedy, in a number of cases pleaded only to get the claims onto the commercial list of the superior court, or used to gain an upper hand in the negotiation with the debtor and other creditors. While corporate law statutes do allow claimants to bring such claims, there may need to be clearer direction as to when the court will consider them in the context of an insolvency proceeding.

i. Initial Changes to Consider

1. *Encourage the court to develop clear criteria regarding when oppression claims will be dealt with during an insolvency proceeding.*

2. *Consider creating director and officer responsibility or liability for the scope and cost of KERP and KEIP during CCAA proceedings.*

11. Template Orders

Standard orders are considered very helpful, fairer to parties and more efficient for the process. Departure from the standard order requires the party seeking the change to bring it to the attention of the other parties and the court, and an explanation to the court as to why it is necessary to do something different. Template orders can also be more efficient, as the standard terms no longer have to be argued before the court. One suggestion was that there could be better explanatory notes accompanying the standard orders, given the rationale for the types of specific terms, so that they are better understood by parties that are not repeat players in proceedings.

As discussed in part 1(iv) above, there was considerable discussion regarding the need for simplification of first day orders, to prevent the extensive gaming that goes on at the initiation of proceedings. A simplified first day order would create greater fairness in first day proceedings and allow for enhanced notice before substantive matters are determined by the court.

Another suggestion was to involve union counsel and representative counsel in committees to develop template orders, so that the orders reflect a more balanced set of base language. A further suggestion was to have a template order for professional fees, which could create consistency in the reporting of work in the proceedings and allow the parties and the courts a clearer sense of the activities of the professionals.

i. Initial Changes to Consider

1. *Enhance the explanatory notes to standard orders.*

2. *Involve union counsel and representative counsel on committees to develop or amend template standard orders.*

3. *Consider implementing simplified standard first day orders.*

4. *Consider implementing a template order for professional fees.*

12. Additional Practice Issues to Consider Addressing

The public meetings raised a number of other practice issues under the *CCAA* proceedings that require deeper consideration. These issues include:

1. *Devise better definitions and metrics as to what constitutes "success" in CCAA proceedings.*

2. *Develop better criteria for determining whether a liquidation should occur under a CCAA or BIA proceeding, or under receivership.*

3. *Develop guidelines for the role of information officers, including the scope of their ability to require disclosure and their obligations to the court and the parties.*

4. *Give serious consideration to streamlining proceedings to control costs and enhance accessibility.*

5. *In determining the best process for the insolvent debtor, consider the importance of whether the business unit should survive.* The example given at one meeting was that in the Pope & Talbot proceeding, supplying the pulp mill was important; if the business survived with zero dividend, creditors were more interested in supplying the business rather than 50 cents on the dollar for their pre-filing claims.[129]

6. *Consider codifying the objectives of the CCAA, including protection of creditors, job protection, protecting of local economic activity, and a concern with the public interest.*

7. *Clarify the importance of social values, avoidance of dislocation, and environment sustainability versus monetary values.* For example, are the costs saved by not having to perform historical environmental obligations worth a company that is able to perform obligations on a go forward basis?[130] Participants observed that social costs provide the fundamental rationale for having the *CCAA* statute.

8. *There should be discussions with the federal government regarding compromising a portion of QST/GST/HST.* The experience has been that if the debtor doesn't deal with the tax authorities, its workout is more likely to fail, but frequently, the government is unwilling to compromise its claims.

III. THE *BANKRUPTCY AND INSOLVENCY ACT*

1. Assessing the Overall Framework

The *Bankruptcy and Insolvency Act (BIA)* provides debtors or their creditors with an opportunity to liquidate businesses in an orderly manner under the bankruptcy provisions of the statute. For individuals involved in a business, it offers them a "fresh start" in that they can begin to rebuild their finances after bankruptcy discharge. For incorporated

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[129] Pope & Talbot, *supra* note 13.

[130] Several participants in Vancouver observed that in *Pope & Talbot*, if the pulp mill had been closed, there would have been $30 million in remedial costs, so the taxpayers of Nanaimo benefited.

businesses, bankruptcy may mean an end to a business, with assets liquidated to satisfy creditors' claims, or the business can be sold as a going concern as part of the liquidation, offering a means of rehabilitation under new owners and managers. The *BIA* also allows businesses the opportunity to make a proposal to their creditors as an alternative to bankruptcy and liquidation, offering debtor companies the opportunity for a fresh start through the mechanism of making a proposal that will settle their debts on terms that allow them to rehabilitate their financial status.[131] Debtor companies can either make a proposal directly to their creditors, or more frequently, they commence proceedings under the *BIA* by commencing a notice of intention (NOI) to make a proposal proceeding. Both proposals and NOI afford the debtor "breathing room" under the 30 day initial stay, allowing them time to negotiate with their creditors and try to garner sufficient creditor support to meet the statutory requirements.

All businesses, but in particular, smaller businesses, including sole proprietorships, partnerships and incorporated businesses, have access to the proposal provisions of the *BIA.* Proposals can be made under the Division I proposal provisions of the *BIA* or under the Division II consumer proposal provisions in some circumstances.[132] The highly codified provisions and trustee supervision have offered a timely and less expensive means of devising a workout plan. The six month maximum period for such proceedings gives creditors some certainty that a proposal will be devised in a timely manner, or the debtor will become automatically bankrupt. There is often new investment and change of corporate ownership, which increases the likelihood of success. In Canada, management are often retained going forward, whereas in the US they are almost always replaced.

Another observation was that out-of-court restructuring is one option that may help to control accounting and legal fees, and such a strategy can avoid disruption with multiple stakeholders such as employees, trade suppliers and customers, as well as protect goodwill.[133]

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[131] Another restructuring mechanism is through secured creditor action, whereby the creditor repossesses the security and assumes the assets in satisfaction of debts and then places the assets into a new entity, thereby settling, acquiring or shedding other liabilities; see for example the default and possession provisions under the Ontario *Personal Property Security Act*, R.S.O. 1990, c. P. 10, at ss. 62-63.

[132] Where the debtor is an individual and his or her debts, excluding the mortgage or hypothec on his or her personal residence, are less than $250,000. The relatively low threshold of $250,000 makes it difficult to capture individuals whose business may have failed, and for which the process under Division I of Part III of the *BIA* may be too onerous.

[133] Janis Sarra, "Failure to Capture the Brass Ring: An Empirical Study of Business Bankruptcies and Proposals under the Canadian *Bankruptcy and Insolvency Act",* examining insolvency filings from 2005 to 2008 (Annual Review of Insolvency Law, 2009) at 427-577.

Generally, participants at the public meetings expressed the view that the provisions are working well. The fact that there were considerably fewer problems identified in respect of the *BIA* provisions, even though the same number of public meetings were held to discuss the *BIA* as there were to discuss the *CCAA,* speaks to the efficacy of the system. Moreover, where problems were identified, there was a relatively high degree of consensus as to what these problems were. While the *BIA* public meetings afforded participants the opportunity to discuss both the bankruptcy provisions and the proposal provisions, as is evident below, most issues identified were in respect of the proposal provisions. A number of participants observed that the commercial bankruptcy provisions are working quite well.

The most significant problem raised by a number of participants at the meetings was that there are a number of small and medium sized enterprises (SME) that require more than the maximum six months afforded by the *BIA* to devise a proposal.[134] They could benefit from a more flexible restructuring regime, as discussed below.

In considering the overall framework, one policy question is whether the *BIA* provisions actually assist in having the debtor address the types and causes of business insolvency coming within its purview. A 2008 study of 6,000 insolvent businesses under the *BIA* found that most businesses had less than $1 million in assets and less than $2 million in liabilities.[135] It reported that the principal causes of insolvency were poor management or money-mismanagement, under-capitalization, downturn in the economy, loss of a particular supplier or source of goods, failure to adjust to changing business circumstances, over-extension of credit, and for partnerships, often a failed business relationship.[136] A survey of 50 trustees across Canada during the same period found that 39% reported that poor management or money-mismanagement was the primary cause of business failure in their experience; 29% of trustees reported over-extension of credit as the principal cause of business failure; and 10% observed that under-capitalization had played a significant role in the business' failure.[137] For sole proprietors, poor management was considered a very significant cause of financial distress. One observation was that there are a decreasing number of formal bankruptcies, as assets

[134] One practitioner suggested that arguably the six months period is not the maximum period to devise a proposal, but the maximum time period available before creditors are directly involved. A trustee can file a "holding proposal" after six months, and continue talking to the creditors until the debtor has a proper plan. The only problem is the lease disclaimers under s. 65.2 *BIA* that must then be issued before the "holding proposal" is filed.
[135] Sarra, *supra*, note 133 at 427-577.
[136] *Ibid.* at 45.
[137] *Ibid.* at 48.

are often sold and businesses wound down without accessing the bankruptcy process under the *BIA*.

From 2005 to 2008, the average debt of all businesses filing under the *BIA* was 30,861 CAD from bank loans, 89% of which were unsecured operating loans.[138] This figure suggests that the majority of filings are very small businesses. Finance company loans were also a significant source of debt for businesses, the average amount of finance company loan was 11,064 CAD;[139] three quarters of this debt unsecured, with the security most often over specific inventory or equipment. There was an average of credit card debt of 19,795 CAD;[140] indicating that small businesses incurred considerable credit card debt in the period leading up to insolvency filing, often to cover expenses when revenues declined and the value of receivables outstanding increased. Loans from individuals comprised a significant source of debt, primarily for sole proprietors.[141] Real property mortgages were significant, and were by far the largest secured debt; the average amount of real property mortgage debt was 40,070 CAD and the median 54,000 CAD.[142] Taxes owing comprised a significant source of debt, with an average of 41,477 CAD; however, the median amount was only 3,520 CAD, suggesting that there were a small number of business debtors that owed a significant amount of taxes.

For incorporated businesses, lack of adequate business plans, poor management, insufficient business revenue, over-extension of credit and downturn in the economy have been identified as five significant and arguably related causes of insolvency. Larger businesses that file under the *BIA* are more likely to have effective governance structures in place, and thus less frequently have problems with poor management as the primary cause. Policy options could include addressing the business plan issue, in particular, planning for market uncertainty and appropriate debt to equity ratio. Arguably, public policy should generally be aimed at encouraging business innovation and entrepreneurship, with insolvency policy aimed more directly at encouraging viable business proposals and supporting restructuring when firms are financially distressed.

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[138] The median was 6,000 CAD. The current method that the OSB uses to collect data is to split each debtor's assets and debts into individual constituents of the overall total. For example, instead of reporting each debtor's total debt as one entry, the OSB reports the value of each component such as the value of a bank loan, mortgage, taxes, and so forth. Therefore, to obtain the median value of all the debtors' liabilities, one would need to manually sum each debtor's individual values into one aggregate amount. However, this process of summation becomes difficult to perform manually over the thousands of entries contained in the Excel file. *Ibid.*

[139] The median was 3,203 CAD, *ibid.*

[140] The median amount of credit card debt was 7,000 CAD, *ibid.*

[141] The average amount was 14,756 CAD, with the median at 8,000 CAD, *ibid.*

[142] 85% of real property mortgages for insolvent businesses were secured, *ibid.*

OSB data from 2005 to 2008 suggest that approximately 45% of business proposals are successfully completed. However, from data that the OSB collects, it is almost impossible to discern how proposals address the causes of insolvency. While the terms of compromise or arrangement are listed, there is little to link how the terms remedy the cause of the business debtor's insolvency. It is unclear that creditors have a clear sense of how any compromise of their claims is going to address the underlying causes of the insolvency. Given that they must determine the amount of compromise that they are willing to agree to, whether as employees, operating lenders, landlords, or trade suppliers, creditors need to have a better understanding of whether the company should be liquidated in order to maximize value or whether there is merit in the proposed compromise or arrangement.

A significant point of failure for proposals is creditor refusal to support the proposal. For all business proposals, 31% fail due to lack of creditor approval.[143] In some cases, creditors make their decision on the basis of whether the potential return to them under a proposal is better than it would be under liquidation. In many cases, how that return is achieved or how or whether the debtor remedies the causes of its insolvency to achieve that higher payment does not seem to be a concern. If part of the rationale for creditors to agree to a proposal is that it may preserve the credit relationship for the future, then being able to assess the connection between the causes of insolvency and the proposal terms would enhance the potential for a credit relationship with the debtor company going forward.

In other cases, the creditors' decision is not strictly a dollar comparison, but also a confidence issue. If the creditors have no confidence in the business or in its management, they will discount the offered settlement and opt for a bankruptcy. That would mean the creditors are not satisfied that the causes of insolvency have been dealt with, and are therefore not prepared to assign a value to the continued supply relationship. If creditors have confidence in the ability of the debtor to be viable, they will attribute a value to the supply relationship in addition to the settlement amount, such that they may support a proposal even if an immediate bankruptcy might return a slightly higher value. So, in effect, lack of credit support may mean a vote of non-confidence in the viability of the debtor because the insolvency issues haven't been properly addressed.

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[143] *Ibid.* at 69.

i. The Efficacy of the Proposal System for Small and Medium Enterprises

All of the public meetings discussed whether the *BIA* proposal provisions actually encourage the rehabilitation of viable small and medium enterprises, and considered whether or not the degree of codification of the *BIA* proposal provisions is helpful or harmful to workouts. Several Calgary practitioners observed that we may not yet have the right tools to restructure small to medium size enterprises. If the company is too small for the *CCAA*, the proposal process can be costly. One practitioner posed the question of whether there is a more cost effective way to resolve financial distress, possibly in the form of an alternate restructuring mechanism. Yet even with its deficiencies, many trustees observed that the *BIA* works relatively well, especially for mid-market commercial files that file under Division I of the *BIA.*

In Montréal, a number of practitioners suggested that the *BIA* has enough structure to deal with small and medium size debtors, but that sufficient court oversight may be lacking in some instances. They observed that a great advantage of a *CCAA* proceeding is that it receives the attention of the court, which in turn keeps stakeholders accountable. The view was that although the court can play this role under the *BIA,* there could be some greater access, without having to bring all matters to the supervising judge.

Others, however, advocated fewer matters going to court. In Halifax, practitioners noted that the cost of legal fees for even the smallest *CCAA* proceeding is 20,000 CAD and that the *BIA* is not much more cost effective, because even though it was aimed at a simplified process that was not court driven, there are increasingly issues being brought before the court, which in turn is driving up the costs. One suggestion at the Toronto meeting was to make the forty-five day extension of the stay period automatic, subject to creditors' rights to protest, alleviating the cost of court hearings where files are uncontested.

Another observation was that judges are completely out of touch with what the process costs and often make rulings such as ordering reports, which can have serious cost consequences for the debtor and diminish possible returns to the creditors. Halifax participants observed that the situation is exacerbated by the fact that under the proposal provisions, there is no opportunity to deal with fees until the end of the process, which can then be problematic. One proposal was to adopt the practice of court-appointed receivers and *CCAA* monitors, and approve the fees from time to time during the process.

In Toronto, there was considerable discussion as to how, under the *BIA,* very small business bankruptcies are being moved into the consumer proposal track. The issue was whether or not Division I proposals are preventing reorganizations, and whether we need a new system for very small businesses. It was suggested that perhaps the "guillotine" timetable and deadlines should be changed; shifting away from an automatic bankruptcy at six months.

While restructuring usually returns more value to stakeholders than liquidation, there are situations where businesses should simply be eliminated. The creditors are the stakeholders that are in the best position to assess whether a business should survive or be liquidated. A number of participants suggested that the courts should be more open to moving the debtor company towards bankruptcy if the proposal proceeding has been preceded by lengthy forbearance or other consideration by creditors; particularly where creditors are certain there is little or no return. However, it was suggested at a number of the public meetings that while some creditors are very interested in the process and take an active part, others are disillusioned and react mechanically to a request for a vote on a proposal because they believe that neither a proposal nor a bankruptcy will return value to the creditors.

Since managerial shortcomings are viewed as the most significant reason for small business failure, one suggestion was that a detailed explanation of how causes of insolvency have been addressed would greatly assist creditors in having confidence in the system. Practitioners in Halifax observed that often a company is dead by the time it files, so a workout is problematic as there is no cash and no resources. They suggest that there is a need for more education of debtors and creditors, so that earlier intervention is possible. Receivership is viewed as an easier route to go. Nova Scotia practitioners noted that if the term lender is on side, there is usually no need to file to do a workout, and if the lender is not on side, there is the challenge of how to create incentives for creditors to bargain. They observed that the proposal provisions are increasingly being used as a form of liquidity, as there are many cases where the business can be saved if a purchaser can be found. Yet they noted that when trying to sell under an NOI, it is difficult to get a section 65.13 *BIA* order from the court.

A process aimed at smaller companies could include more flexibility in extensions of the stay period. Six months was viewed as an issue, particularly in Vancouver, Toronto, and Halifax. Practitioners suggested that there is often not enough time to get a good

proposal in place. The proposal trustee tries to reduce the costs and the amount of time it takes to get to court, but often the financing takes time to put together.

One practitioner observed that if one considers proposals as essentially a sale of assets, there is not sufficient information to determine whether such sales under proposal proceedings result in better returns for creditors than bankruptcy and liquidation. In Québec, there was concern expressed that not all sales are approved by the court, or the court is approving such sales without considering the relative importance of the assets to the overall business. Such lack of oversight may disadvantage creditors, particularly those creditors implicated in the potential ongoing business enterprise, such as trade suppliers, employees and pensioners.

If a medium-sized debtor company does develop a formal proposal, it tends to do it at the end of the planning and negotiation stage, not at the beginning; the only exception is where the debtor needs a stay and then it files a notice of intention with the support of senior lenders. Many participants were in favour of giving the court more flexibility in the Division I provisions, by giving the court greater authority to fashion a remedy for the particular set of circumstances. However, it was generally felt that there should not be as much flexibility as *CCAA* proceedings, because one strength of the *BIA* is its structured timeframes, which do give creditors confidence. One practitioner suggested that judicial authority and discretion are already built into the mechanisms; otherwise, Parliament should just give more express authority to the court to exercise its power and discretion without having to come up with an entirely new proposal process.

Alberta practitioners spoke highly of their access to the courts on very short notice. Such is not the case across Canada, since in Ontario there are only a limited number of registrars (now masters) in the province, and in other jurisdictions, there is a delay before the trustee can appear before a registrar or the court to seek directions.

It was also pointed out in several meetings that some secured creditors dislike the proposal process and often use the thirty day stay extension hearing to argue that the situation of the debtor is hopeless, asking the court to place the debtor into bankruptcy. A practitioner observed that one cannot assume that secured creditors want to help the debtor. For secured creditors, the cost is a big factor. If creditors have a choice between a Division I *BIA* or a *CCAA* process, they are going to choose the *BIA,* given the administrative costs. But their first preference may be bankruptcy.

One lender at the Montréal meeting observed that getting the smaller debtors into the *BIA* earlier would be a tremendous help. By the time they get to the *BIA,* there is often very little left to do. Banks and other lenders tend to put smaller debtor companies in the special loans area and let them sit there "in purgatory". Another Montréal participant observed that the provisions of the *BIA* often cannot apply to small business owners, as they don't have anything to give as security. He would like to see a process in between current commercial and consumer statutory provisions, as sole proprietors who are incorporated could survive with some help. He suggested that a more flexible process would still protect the rights of the creditors, without all the conditions that the debtor needs to live with under Division I.

In small files, it was observed that the trustee has a very important role in everything. Debtors frequently do not know how to do a cash flow statement, and they often do not have an accountant. In a few files, the proposal trustee can move forward because the debtor has some money left. One participant noted that many debtors have $500,000 or less in debt, and they are not well financed. The creditors don't even give them a loan now, but the debtor has managed to get a $30,000 limit credit card, which it has run up as a very expensive form of financing, paying up to 30% interest. One participant observed that it is not that small business owners don't have a good business; it's just that they are not well financed at a reasonable rate.

If a business is not incorporated, it can have access to the consumer proposal provisions of the *BIA*, and can benefit from the simplified requirements. A number of participants indicated that Division II proposals work well because they are streamlined. The reports are simpler. There are fewer meetings with the creditors. The trustee only has to go to court if there is a disagreement. The recently amended liability cap of 250,000 CAD excluding mortgages under Division II has provided much more access for debtors. Trustees observed that they do get self-employed individuals who really should be under commercial proposal provisions, but they proceed under a consumer proposal because of the amount of debt allowed and because it is a much easier and less costly process. Trustees reported that they often get 100 or 75 cents on the dollar in such simplified and less costly proceedings.

In Halifax, the increased cap of 250,000 CAD drove a number of businesses into consumer proceedings and practitioners observed that sole proprietorships can be quite complicated to deal with under the consumer proposal provisions.

However, a small incorporated business does not have access to the Division II streamlined process. A process for very small businesses could be fashioned along the line of consumer proposals, including more informal calls with creditors and a creditors' meeting required only where a specified threshold of creditors request it. Trustees suggested that often creditors' meetings are called and no one has shown up after an hour, creating a waste of time and resources. A streamlined process for very small businesses could remedy that problem. It was noted, however, that it is important that creditors do not feel that their rights to participate are being compromised.

In Toronto, it was pointed out that there is always another side to a streamlined process, and that there are cases where things should have been vetted more by the trustee. Sometimes proposals don't pass the "smell test" and trustee has to strike some balance between creditors' and debtors' interests.

There was some concern expressed that a streamlined procedure for small businesses could allow them to manipulate the system. Debtors may hide assets and favour some suppliers. The goal of the process should be transparency and forgiveness of debt. The onus is on the insolvency professional to advise the debtor of its obligations under the *Act*. One view was that the small business person can often just start another business; they have frequently burned their bridges with their suppliers and the creditors don't want to help, they just want them to go bankrupt. Another participant observed that the moment debtors start defaulting, creditors start hammering them in fees, and debtors just keep limping along instead of addressing the financial or operational problems.

Another Calgary participant observed that it may not be possible for creditors to have confidence in the insolvency system if they don't receive a detailed explanation of the causes of insolvency. Absent that information, how can the creditors make an informed decision on a proposal.

One suggestion in Calgary was to consider adopting a mechanism such as under the *Farm Debt Mediation Act*, whereby mediation is required or encouraged for small and medium files. Such a mechanism might "kick-start" negotiations earlier, allowing smaller debtors the chance to mediate a resolution. Often, for very small companies, the process is a sale back to some part of the original equity ownership, and one practitioner suggested a mediation mechanism might save time and cost in crafting such a resolution to the financial distress.

In Nova Scotia, there is a recurring problem of debtors coming to the process unprepared, for example, during foreclosure or loss of their home due to personal guarantees. The trustee is asked to help far too late. In terms of amendments that might create a simplified bankruptcy process for small debtors once a proposal is not possible, Halifax practitioners suggested more simplified options, such as not requiring inspectors for small files.

Sometimes unsophisticated trade suppliers have the view that they are protected once the debtor enters a proposal proceeding, that somehow the court will protect their claims. They don't know the conditions and priorities of the interim financing. One solution might be that part of the notice that goes out with the notice of intention includes a caution, such as a few sentences that say "there is no guarantee that if you continue to supply that you will be paid." Others suggested critical supplier provisions should be enacted to align the *BIA* proposal provisions with the *CCAA* provisions. Creditors are always taking a risk if they continue to supply, but should be advised of the risk. There is a huge need for both debtor and creditor education on the small business side.

ii. Interim Financing

The most recent amendments to the *BIA* codified, for the first time, the availability of interim financing during proposal proceedings, to enable the business to continue to operate while it attempts to restructure its debts, including a priority charge by the interim lender in respect of the amount lent. Section 50.6 authorizes the court to grant a charge against the property of a debtor in respect of interim financing, subject to certain limits. In deciding whether to make an order, the court is to consider, among other things, the period during which the debtor is expected to be subject to *BIA* proceedings; how the debtor's business and financial affairs are to be managed during the proceedings; whether the debtor's management has the confidence of its major creditors; whether the loan would enhance the prospects of a viable proposal; the nature and value of the debtor's property; whether any creditor would be materially prejudiced as a result of the security or charge; and the trustee's views.

While generally there was broad support for the interim financing provisions enacted in the *BIA* for proposals, there has been almost no experience with them. Participants across Canada have seen very few files in which DIP financing was sought or granted to a *BIA* proposal debtor. Most felt the availability of such financing was the problem, not the willingness of the companies to use it. Moreover, to participants' knowledge, there has

only been one DIP financing application under the *BIA* that has been contested by the parties.

An issue for debtors with viable business plans or the potential for such plans is that the market doesn't exist for a small amount of DIP financing. Sometimes the proposal trustee assists the debtor in borrowing less than the value of the company, and it is not a problem. However, the cost incurred to the lender is very high and one lender observed that a DIP lender has to do a DIP facility of at least 150,000 CAD before it can make any money.

In Québec, there is registration of DIP loans, which does not occur in most other provinces. Practitioners observed that registration helps because the creditor does not want to have another creditor coming in without its knowledge or without the new creditor knowing that it has a priority claim. The general view was that no matter how simple it is to do the DIP financing, it is not going to happen with small companies. They only ever have one secured lender who holds all or almost all of the debt. In Vancouver and Calgary, participants noted that there are simply not third-party lenders willing to advance interim financing under the *BIA*. In Alberta, any needed cash injection to "keep the lights on" usually comes from equity investors or existing operating lenders.

In Nova Scotia, there have not been any DIP financing arrangements made under the new *BIA* provisions, the cost of such financing cited as the reason. Practitioners in Halifax reported that as soon as the NOI is filed, the bank freezes the accounts and another lender is needed but such financing is not available. They suggested that there should be a simplified means of getting DIP financing under an NOI or proposal proceeding.

In Calgary, one lender observed that if the size of the debtor is that it has ten million in assets, the cases are typically dealing with a single secured lender, with a non-complex debt structure. He observed that usually the families that own the business are the second lenders, and already have the money figured out, such as with a forbearance arrangement. Thus, it all gets worked out in the process with existing financiers or family members that own the closely held business. Often, in such files, there is confidence by the lender in the management of the debtor; otherwise the senior lender will not support the process at all. Another Calgary lender observed that often it will finance because of what the lender views as temporary market conditions causing the financial distress, not governance failure.

Another lender observed that every file has some form of interim financing, since the old financing continues while the debtor company seeks a solution to its financial distress. With the most recent amendments, he wondered if it was as clear about credit terms under pre-filing agreements. In Vancouver, participants noted that in many proposal files, the existing financial institution lends more, which is a form of interim financing, with the DIP facility having priority over other secured creditors who are already there. The cost for the financial institution is the same in terms of due diligence and monitoring. Others noted that as the asset base is smaller, the costs of financing or the costs of the proposal trustee become a barrier to a workout proposal. The reality is that asset bases are too low to attract a new lender. Thus, the issue is less the process set out under the statute, and more the practical reality of a thin lending market for the size of the firm.

One participant suggested that we are short sighted in not recognizing the significance of SME in the Canadian economy, and that there could be a viable interim financing loan program created by the federal government. One suggestion was to have some kind of variation on the *Small Business Loans Act*, so that the government would back interim financing loans. One participant observed that there is now some interim financing from the BDC, but it is slow in developing. While secured creditors often are unwilling to accept a proposal, suppliers are often willing to take 50% or 30% of what is owed if there is a prospect of a continuing trade relationship.

Another observation was that the government as a creditor is often reluctant to accept 50 cents on the dollar on a business proposal, but is willing to do it when the business drops into a consumer proposal. Hence, it is another driver for small businesses to file under the consumer proposal provisions. The question really comes down to how much the government trusts the trustee's documents, and is willing to finance some of the workout through compromise of its claims.

One of the key issues for small businesses is access to cash in the proposal. The smaller the debtor is, the harder it is. A proposal has a short timeframe, has the cost of a trustee, and ultimately dilutes the founder's equity. One option suggested was to keep the timeline at thirty days and have the trustee give a stronger report on cash flows, which may create some incentives to lend into the situation.

In Halifax and Calgary, trustees stressed that often secured lenders and business founders are really just trying to find the easiest exit from the situation; and that a sale of the business is often the best strategy to maximize value for creditors. Yet six months

may not be long enough to effectively market the business and set the best price, and often some form of interim financing is needed to be able to sell the debtor's business as a going concern.

iii. Extending the Six Month Deadline

There was a very lively discussion at all the meetings as to the benefits and pitfalls of extending the six month limit for proposals. Some worried that a shift away from rigid timelines would give too much control to the debtor. Others suggested maintaining the six month limit, but authorizing the court to grant relief in exceptional circumstances, with clear criteria to be applied. In Montréal, there was also some interest in granting the court authority to relieve against the tight timeframes, if clear criteria were set out in the statute.

In Calgary, the view was that if the debtor and proposal trustee can't get the proposal done in six months or at least considerably on the way, the costs start to run out of control, and creditors are fatigued. The NOI was supposed to be the cheaper alternative to liquidating. Because many small/medium restructurings take more than six months, and because it is so final, debtors often hang on too long before they file because they fear the six month "guillotine".

Most cases under the *BIA* business proposal provisions are small and mid-market commercial businesses. Typically, the proposal trustee has a back-up plan and can deal with assets of the estate and figure out a way to deal with a failed proposal if the six month deadline passes. One trustee observed that six months is not really the end of proceedings; it is a time to show up in front of the creditors to account for progress or not; and if acceptable to creditors, a "holding proposal" is then approved by the court and further negotiations occur.

Another suggestion was to devise a system whereby when the stay periods come up for renewal, there could be a window in which creditors could object and if there is no objection, the stay can be extended without the need for a court hearing. The view was that such an approach could protect creditors and reduce some of the administrative costs. In terms of the 45 day reporting back, there was considerable debate as to whether there should be flexibility, but overall, practitioners felt that the tight timeframe keeps debtors accountable to creditors, and the focus should be on an efficient mechanism to extend the period where creditors do not object.

One issue with small and mid-market companies is simply the cost of going back to court. Calgary participants discussed whether there was any way we could meet the needs of reporting to the secured creditors without the cost of multiple court appearances. One option is to standardize the reports, especially on the 30 day come back extension. Then the trustee could just report that the debtor is acting in good faith and with due diligence to develop a proposal and that there are no material issues or changes, leaving it to creditors to advise the trustee if a court appearance is requested.

One suggestion was that since the judge has already seen the trustee's initial report, it might be feasible to pare down the costs by just requiring the proposal trustee to give the court an update as opposed to resending the entire report.

In Calgary, it was noted that there is quite a push to use the commercial duty list, but then parties are not seeing the same judge every time, which uses up time and resources to brief the judge on the status of the proceeding.

In Manitoba, for smaller and medium sized debtor proposal proceedings, one practitioner observed that there are always going to be companies for whom the process doesn't work because there is either not enough funding or not enough debt. He suggested that if there was a system where a party could walk in and see a judge, who has the authority to make an order to bind people after sitting down and hearing what the parties need, you might actually be able to bring more stakeholders into the framework. The current system encourages a lot of preparation in advance. Another participant suggested that if the court in the existing process had more flexibility on the first return date, it would be helpful. However, others were less certain that more flexibility would actually save money, because one of the elements of the proceeding is that parties have to go back to court to justify that they are doing it right, and there can be advantages to having this certainty in the process.

Québec uses the *BIA* proposal provisions more than other jurisdictions, and practitioners there reported that it is rare that the courts will give the debtor the full six months allowable. Typically, the court will allow only two to three extensions, because it wants the debtor to get things done. However, one trustee observed that for complex files, there isn't enough flexibility.

Many observed that a *BIA* restructuring is different from a *CCAA* restructuring, There is less communication because such systems in the company are not well developed and the people handling the financial information are busy. Some participants felt that the forty-five day report back is very important as it a reasonable period for a debtor with fewer supports to get the information regarding financial, operational and market information. Halifax participants observed that the majority of files in that province need an extension, largely because the financial records are in very poor condition. Most of the trustees that are doing these restructurings have a lot of experience in protecting both the debtor and creditors. Larger creditors have their own advisors, and they will make their own judgments, but smaller creditors rely on the proposal trustee for a timely and fair process.

In both Vancouver and Montréal, there were issues identified in respect of the six month limit and being able to get property contracts or financing in place in such a timeframe. *BIA* proposal proceedings are popular in British Columbia because they are predictable. Yet sometimes the trustee is on a worldwide search for purchasers, which takes time. To have a little more flexibility would be highly appropriate, but participants were not suggesting an indefinite extension. One judge observed that there needs to be a balance between flexibility in a deadline and keeping people's "feet to the fire".

Other trustees suggested that with proposals, the court appearance brings people together and makes them cut deals that need to be cut. Many concluded that six months is the right period for SME. Despite the cost of court extensions, if it is consensual, then the hearing isn't expensive. If it is not consensual, then perhaps the parties should be in court. Others pointed out that the most difficult extension issue is the first one. Thirty days is too short. Hence, one suggestion was to legislate the first extension on a reverse onus basis, provided that there is a full trustee report.

One participant in Vancouver observed that the difficulty with court extensions is that parties end up there because they have to. Small creditors need it for enforcement. Other creditors need it because they have not seen sufficient disclosure. One problem identified is that the trustee can't force information from the debtor in the same way that a monitor can under the *CCAA*, and it was suggested that this authority could be enhanced. Others felt that the trustee already has sufficient authority and in some cases, needs to exercise it more forcefully.

One serious issue identified in several cities is the delay in government responding to proposals where it is a significant creditor. In particular, trustees report that it is almost impossible to get Canada Revenue Agency to respond to proposals, creating huge time delays. Moreover, the view was that the federal government has less incentive to compromise and that it is often the cause of a failed proposal.

Practitioners observed that if the dollar threshold on the *CCAA* is raised, there will be many more *BIA* proposal cases with more complex issues and cross-border filings, in which case the provisions may need to be examined for their ability to deal with complex debt structures.

iv. Control and Accountability

One issue discussed at length during the Calgary meeting was whether there is too much control over the process by existing business founders and shareholders, given that they have little or no equity remaining. One view was that companies will be hesitant to go into a proposal proceeding if existing management and shareholders of closely held private companies are going to lose control. On the other hand, it was suggested that if one wants to prevent existing management from inappropriately retaining control, it should be made easier for creditors to initiate proceedings. There is precedent for creditor-sponsored proposals, but there is a sense that the courts prefer that management has first crack at trying to devise a proposal. One approach could be to make the playing field completely level.

The experience of numerous insolvency practitioners has been that if there is a hesitancy to commence an insolvency restructuring, it is because managers are going to lose control of the process by putting it in the hands of the court. Existing management is usually there because of their ties with shareholders. One participant observed, for example, that in one proceeding, the principal of the company had guaranteed the obligations to the first secured creditor. The practitioner was acting for the second secured creditors, which made a move for a creditor-sponsored plan. There were enough assets to satisfy the claims of the first creditor, but not necessarily the second. It was critically important for the second secured creditor to sponsor the plan, because there would likely not have been any recovery otherwise. Another participant suggested that it might be easier for the equity participants controlling management to risk the position of the second secured creditors to get as many dollars as possible during the restructuring. The risk is that if it doesn’t go well, then the losers are the second tier lenders. A number

of economic factors can prejudice creditors if they don't have the ability to sponsor a plan and take control of the process, or at least be able to ask the court to do so. When there are disputes amongst creditors, it is very important to strive for fairness in terms of who can initiate and control the proposal process.

Concepts such as management having the exclusive right to first try to devise a proposal for six months can be very expensive. In the US, it was observed that the exclusivity period is viewed as detrimental to many creditors. In general, there appeared to be little support for implementing an exclusivity period for filing proposals and NOI. One practitioner observed that it is necessary to consider who is still in the money in devising procedural changes. The thrust of the restructuring process is to compromise, and his view was that if one creditor class is compromising a dollar, those below should get nothing. Another participant noted that if one gives too much leverage to the parties who are out of the money, there is an unfairness that could be created. Another observed that there are a lot of cases that at day one, the officers are out of the money beyond their employment, and often they are in the best position to effect the restructuring, but that one of the first things they want to get in place is their KERP.

One suggestion to create greater accountability across files involving the same directors or principals was to create business numbers, like social insurance numbers, that stay with the person as he or she creates different businesses. Currently, business numbers go into limbo when the business fails. An individual's social insurance number stays with him or her forever. As a small business owner, there is not the same kind of tracking. The debtor can just start all over again with businesses B, C, and D, leaving unsecured creditors with their losses each time.

The overall sense is that fraud is involved in a minority of cases, although in some meetings, practitioners suggested that it may be on the rise. More often, very small businesses are leaving it too long before they file a NOI or proposal because they had some skills and ideas, but no business plan or management capacity. It is a combination of good faith and mismanagement. They wait a long time before seeking help for financial distress. The view was that it might not be a *BIA* problem, but rather, more about how to educate small businesses in finance and management.

A different approach is needed to promote early intervention. One issue identified was that credit counsellors cannot give advice to small businesses that are incorporated, and thus, these businesses may not know that a proposal is an option until too late. Yet many

sole proprietors and small businesses are encouraged to incorporate when they are formed in order to limit their personal liability.

In some cases, the directors and officers that may have created the financial distress are given too much authority to work them out in an out-of-court process, possibly to the detriment of both equity and debt investors. The oppression remedy may be available to some stakeholders, but it does not address the need for a workable restructuring that corrects operational and financial problems. Secured creditors should have the ability to bring a proposal to restructure, and failing that opportunity, are more likely to opt for liquidation. In Calgary, it was noted that it takes a special set of circumstances to even consider it, related to the number and type of creditors involved. He had tried one or two informal processes that "just didn't get out of the gate". Practitioners noted that what is missing is the hammer, i.e. the statutory authority that creates a timely process. There can be unfair treatment across the board and the debtor can abuse the lack of reporting, although some workouts have been successfully accomplished with informal processes.

v. Initial Changes to Consider

1. *Consider statutory language requiring that proposals presented to creditors must specify how the causes of the insolvency are being addressed in the proposal.*

2. *Consider implementing a business proposal process that is more streamlined and less costly, such that businesses are no longer using the consumer proposal provisions to bypass statutory requirements. Such a process could include shorter timelines for reporting back to the court and completing a proposal, and automatic extensions of the stay unless one or more creditors object.*

3. *Consider implementing a more flexible process for small and medium enterprises (SME), giving the court the authority to adjust the 30 or 45 day stay period where the court is satisfied there is a need. It would require setting out principles and criteria to be applied by the court, creating transparency and protecting all stakeholders.*

4. *Consider implementing a very small business proposal process similar to consumer proposals, available also to incorporated business, whereby much of the reporting and appeal process works on a default basis, as with consumer proposals.*

5. *Consider retaining the six month cap on developing proposals, but grant the court authority to extend the period in exceptional circumstances, codifying the criteria that the court should apply in such circumstances.*

6. *Ensure trustees are appropriately compensated in administering these new processes.*

7. *Credit counselling should be made available to small businesses that are incorporated.*

2. The Role of the Proposal Trustee

The role of the trustee in the notion of intention to make a proposal (NOI) period is critically important, as the trustee offers a professional impartial view of the potential for a successful proposal. Trustees must be diligent, mindful, avoid conflicts of interest, and be aware that there is a perception among creditors that the trustee is not independent, but rather, allied with the debtor. Several participants in Toronto suggested that more guidance may be needed regarding the authority of the proposal trustee and the scope of its duties. The work under a proposal is considerable for the insolvency professional because the debtor is often unsophisticated.

Many practitioners observed that one advantage of the *BIA* process is that filing the NOI is amazingly simple and quick. An NOI can be filed in 24 hours, with straightforward duties of the trustee, whereas the *CCAA* has a lot more preparatory work and drafting pre-filing. One concern raised was the amount of time and effort proposal trustees are putting into monitoring the cash flow. In *CCAA* proceedings, the monitor reports regularly to the court and the creditors in respect of how the cash is being burned. It was suggested that creditors in proposal proceedings want to be satisfied that the liquidation value is above the secured credit levels. If the information is enhanced, then it is up to the creditors who think they are being prejudiced to make their argument. Currently, it is dependent on the proposal trustee to alert creditors and the court about any risks associated with the burn rate.

One practitioner suggested at the Vancouver meeting that there should be an initial meeting of creditors to set out expectations for the proposal trustee and the process as a whole. Another Vancouver participant observed that one of the most common complaints

by a debtor is that it has filed for a proposal and says that the trustee is not representing its interests, not appreciating that the role of the trustee is not to be an advocate for the debtor. He notes that there is not a clear statement about what the proposal trustee is supposed to be doing in the *BIA*, and a clearer acknowledgement of the role is needed. For example, the engagement agreement could specify: "I have read and understood the role of the trustee to be as impartial court officer, working in the interests of all parties."

There are more obligations that have been placed on the trustee with the most recent amendments to the *BIA.* One practitioner suggested that in many *BIA* cases, the trustee must spend one dollar to generate a return of two dollars for creditors. Participants observed that the trustee has a difficult task to find value and craft proposals that are fair and equitable.

Both debtors and creditors are concerned with the fees and cost of retainer. One practitioner observed that previously, creditors only had to deal with the deemed trust, trustee fees, and trustee fees' remainder and distribution. She noted that now that the schedule is a lot longer, the point of entry for a viable proposal is much higher and it is harder to see what the distribution could be. Debtors are nervous about going into the process and creditors see how far down the statutory priorities list they are and think it is not worth it.

Trustees often find that the financial situation is much worse when they get into the debtor company's financial records. It is hard to see the real situation at the point of engagement. The security of assets thus becomes important. One trustee observed that there is no one who is recognizing the early warning signs of the small debtor's financial distress, and trustees sometimes get into engagements where they have lost their opportunity to devise a proposal even before they commence. Trustees would like to have some preview as to the size of the file before it must accept it.

One trustee observed that he has been in situations where he has recommended creditors turn down the proposal, but the significant creditor wanted to accept it anyways, and the court had to intervene.

Generally, there continues to be a lot of confidence in trustees across the country. One participant noted that if she is advising a creditor, unless it is unique as a critical supplier, and where there is confidence in the trustee's report, the advice she gives is to watch and wait for distribution. It was noted that creditors tend to be critical of trustee fees only

where they think that the contribution of the trustee has not aided realization of value or advancing the public interest. Sometimes creditors acting together will complain if the distribution is not to their satisfaction.

An important issue for trustee remuneration is that previously, if there was a shortfall in the trustees' fees, trustees could recoup them in the bankruptcy. Now, the court has said that if the trustee has a shortfall, it does not have access to the assets in the bankruptcy, making the proposal trustee an unsecured creditor. Now trustees are going to require significantly higher retainers when they don't know what they are getting into, since they do not have priority access to the assets. Hence, administration fees need to be analyzed more carefully and protection of professional fees needs some adjustment.

One trustee observed that she has seen greater use of proposals as the debtor company gets closer to $5 million in debt, and that where she would have used the *CCAA* before, it has become too costly. The proposal trustee's role differs considerably from that of a monitor, and one suggestion was to create the possibility for proposal trustees to serve in a capacity closer to the role played by monitor in *CCAA* proceedings where files are more complicated and the financial and operational issues are harder to work out. That suggestion sparked a discussion as to whether the court has sufficient authority under the *BIA*, or whether some further codification would be required.

There is an obligation to report to the creditors, but one question raised was whether that obligation is a statutory obligation. One suggestion that was discussed at several meetings was having the proposal trustee give its views periodically to the court and stakeholders on how the cash is being used up, affording creditors both the opportunity to know who is being prejudiced and the opportunity for creditors to make the case for a shorter stay period or to be able to develop their own proposal. In that respect, more options for a resolution could be placed before the court, with the proposal trustee giving its opinion on the various options as the court's officer. Alternatively, rather than making the periodic reporting by the proposal trustee mandatory, creditors could be given the right to ask the proposal trustee for a report commenting on cash flow, progress on development of the proposal, and what any further draws on credit are being used for at specified periods during the process.

Trustees observed that they have occasionally used a chief restructuring officer when they have issues with management in proposal proceedings for mid-market files. They want to address operational and management issues and use the restructuring process

to fix problems, as restructuring proposals are weighed against the outcome of liquidation. If the trustee and creditors can see a better result in going through a proposal process, they are quite interested in going that route, even with the cost of a CRO.

i. Initial Changes to Consider

1. *Clarify that proposal trustees' fees after a failed proposal are a lien on the assets of the bankrupt estate.*

2. *Provide potential trustees with a mechanism to preview the size and complexity of a BIA proposal file before the trustee must accept it.*

3. Receivership

While receiverships were generally reported to be a highly effective mechanism, participants at the public meetings discussed improving aspects of receivership, including authority for receivers in terms of assigning leases, dealing with derivatives, and gaps in priorities. One recommendation was to have better standardization among all statutes, provincial statutes, the *BIA* receiver, and *CCAA* receiver, with a consistent set of rules regarding their powers to act. Others suggested, however, that private credit agreements authorizing appointment of receivers on certain events occurring should not be tampered with, as the right to contract should be protected.

Receiverships are increasingly being used concurrently with proposal proceedings. In Halifax, practitioners observed that they combine the trustee under a proposal proceeding with an interim receivership appointment, according the role more power. They reported that most cases in Nova Scotia are done this way now.

In Québec, a practice on occasion has been to file a notice of intention and the sale goes through the receiver, after the NOI period starts but prior to development of a proposal. In some instances, there was no approval by the court. Others at the meeting expressed the view that they would rather have the approval of the court for their sale process; then, by the time six months is up, the trustee/receiver may file a basket proposal with a token amount of distribution.

In Toronto, several practitioners observed that for *BIA* proposals, there is usually a receivership tacked on. If there aren't enough assets, the proposal deals mainly with the unsecured creditors, and the practice is to get a *BIA* national receiver appointed. The receiver needs to make sure the sale process is fair, especially with small businesses, where often the existing owners are the only people who are willing to buy the business as they tend to see more value in it. They often find someone to finance it as an asset sale, but not as a proposal. Another trustee observed that the banks take a financial hit when the owner buys the assets back under a new company, but it can be an effective mechanism, where the owner buys it back with new money. Others observed that with small businesses, the biggest barrier to a proposal is the lease. If the debtor can't negotiate a deal with the landlord, then that is a stumbling block; a sale of assets by a receiver may resolve that issue for the founder owner.

One suggestion in both Toronto and Calgary was to have a standard set of appointment and engagement letters for receivers under the *BIA* or *CCAA*. The standards of professional conduct set out professional expectations and could be used as the baseline for such standardized letters. That way the creditors have no say; there is no need for a creditor meeting. Another suggestion was creating a system with three gradations, reflecting different levels of cases. At the bottom, the situation is hopeless and no one is interested in a workout; there is no fraud, just incompetence and mismanagement. At the other end of the scale, it is a complex case or there are badges of fraud. The procedure used by the receiver would be based on the amount of administration required to undertake a liquidation.

Others at the meetings took issue with the dichotomy between liquidation and restructuring in terms of receiverships in or out of proposal proceedings, suggesting that definition is less important than ensuring an appropriate outcome. One participant used the example of an inventor whose business is in trouble and the receiver determines that a quick sale is appropriate; it does require court approval, but there is an understanding of the speed required; there is nothing for the unsecured creditors, the banks get some return to sign off, and then there is an asset sale. The inventor is then off to start a new company with new ownership and the court will satisfy itself that there isn't an inappropriate transfer of value from the old business to the new. A scholar in Montréal observed that the current law on the distinction between liquidation and restructuring is linked to the issue of the underlying causes of business insolvency, and a business resolution approach is sometimes incompatible with the law as framed.

All the meetings discussed whether or not informal proceedings under the guidance of a receiver are problematic in that the debtor company only negotiates only with the most powerful creditors. Overall, it was felt that informal processes can ensure a business resolution rather than a legal one, but fairness versus unfairness really depends on the calibre of the receiver.

In Manitoba, receivers are finding a way to take out the lead secured creditor at a discount and leave the rest of the parties alone. Generally speaking, the view was that it is very difficult to do informal restructuring. If the debtor has enough cash flow to do it informally, it has enough to do it formally, and there is certainty that all claims have been dealt with. If the receiver misses a few creditors, they will come back six months later seeking resolution of their claims. Informal proposals fail to capture all of the constituencies. If the debtor is in forbearance proceedings with its senior secured lenders, the receiver can compel them to do an informal proposal if there is a manageable number of unsecured creditors. However, often, if the first secured creditor exercises receivership, the debtor and unsecured creditors will get nothing.

In Montréal, there was discussion as to whether the role of receivership under section 243 of the *BIA* needs some further clarification; not necessarily a change in statutory language, but greater clarification as to when it is appropriate to access the *BIA* receivership provisions, and an analysis of any gaps when what a creditor is trying to accomplish is less than control or possession of “all or substantially all” of the assets. Some of this discussion was echoed at the Halifax meeting.

In Halifax, participants reported that there is sometimes a disconnection between the OSB and receivers regarding the assets being seized for realization. One practitioner suggested that s. 244 should offer more self-help remedies. One identified problem was that the trustee is trying to get the best price in the sale but a senior creditor wants to control the process, which can work against creating a good market for the sale.

Practitioners observed that in the past two years, there have been a number of cases in which arguably there has been an underestimation by some receivers of the time, expense and complexities of assignments they take on. In turn, such cases can lead to either cutting the job they might otherwise do, or it might lead to them refusing to take similar assignments in the future. The public meetings discussed whether or not there is an issue regarding the fee structure that requires further examination, in terms of both the level of service and the incentives it may create.

The issue of receiver liability waivers was also raised at three meetings. Participants observed, for example, that at recent hearings in Alberta and Ontario on the discharge of receivers, the receivers were seeking liability waivers that were far beyond protecting them for undertaking their receivership mandate. It was suggested that the courts should be reluctant to grant such far reaching protection from liability as it may create incentives for the receiver not to be duly diligent.

i. Initial Changes to Consider

1. *Create a standard set of appointment and engagement letters for receivers under the BIA and CCAA.*

2. *Clarify the role and authority of the receiver under s. 243 of the BIA where "all or substantially all" of the assets are not involved, or amend the statute to allow the use of receivership authority for particular assets of the debtor during proposal proceedings.*

4. Offences

In Toronto, participants emphasized that honesty is a fundamental feature of the bankruptcy framework, and that bankruptcy is a second chance for an honest debtor. Yet in some cases, dishonest or willfully negligent management is continuing to siphon off money, and those debtors are most appropriately liquidated. Moreover, offences committed by the debtor under the *BIA* or its criminal conduct should be pursued to ensure assets are brought back into the estate to satisfy creditors' claims. In that respect, there was broad consensus that trustees need to be reminded that they should report *BIA* offences, other administrative offences and criminal conduct they discover to the appropriate enforcement authorities. One practitioner observed that trustees should, by their professional standards, recognize that they have a duty to report offences under the *BIA* or criminal activity of the bankrupt company if it comes to their attention while they are administering the estate.

In most cities, participants discussed the difficulty in getting the RCMP to lay charges. There is inadequate funding to pursue fraud in both bigger and smaller cases. The OSB has enhanced its special investigation unit in Montréal, also hiring in Vancouver and

Toronto. Its intention is to shift its enforcement focus to ensure debtor compliance with the statute. There appears to be improved institutional support for pursuing enforcement, although it is early days and most practitioners have not yet seen results. One government representative at the Toronto meeting noted that trustees should report the matters, including where offences are not pursued, because data that supports the need for more resources will make them easier to get.

5. Are the 2009 Amendments to Restructuring Provisions of the *BIA* Effective?

The extensive amendments to the proposal provisions of the *BIA*, effective September 18, 2009, were aimed at enhancing the ability of business debtors to effectively restructure where they can devise a viable business plan, codifying rights and expectations in respect of restructuring, aimed at greater consistency in the process. Many of the amendments were enacted at the request of the insolvency profession, based on specific problems that trustees and administrators were encountering. It is helpful, after several years' experience, to discuss whether the amendments that the profession advocated are effective, or whether further retooling is required. Some amendments, such as interim financing, have been discussed earlier in this report. The rest raised at the meetings are discussed in this part.

i. Cash Flow Statements

Changes included requiring the cash flow statement on at least a monthly basis,[144] and the trustee ensuring that creditors receive a report about any material adverse change without delay after receiving information regarding the change.[145]

The general consensus at the meetings was that the required cash flow statement provides creditors with more accurate financial information to determine when and whether they want to participate in the process. Yet there were a number of concerns expressed in all the cities about the timing of the initial cash flow statement and the trustee's role at that point in the proceeding.

In Calgary, the observation by one participant was that the cash flows are a very early indicator to creditors as to the trustee's professionalism and impartiality. Given the

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[144] *BIA,* s. 50(2.1) was enacted to ensure that the official receiver receives the documents in a timely manner.
[145] Section 50.4(8)(b.1) of the *BIA* provides that the official receiver does not have to rely on the trustee's report before issuing the certificate of assignment.

amount of discretion in calculating both anticipated expenses and revenues, creditors look to see if the trustee is being realistic and balanced in its opinion. It may also be an indicator of the degree of disclosure that the trustee, and in turn the creditors, are receiving from the debtor company. However, another observation was that the trustee can be perceived too quickly as acting for the debtor company, particularly in situations where the cash flow projection appears unrealistic or where creditors have not previously been involved in *BIA* proposal proceedings. This perception is exacerbated by the fact that the debtor company selects the proposal trustee. A suggestion in Halifax was that perhaps the OSB could publish clearer information on the role of the proposal trustee in developing cash flow statements, with a view to creditors' interests.

Another participant observed that it takes a long time for parties to understand that the cash flow statement is what the debtor wants it to be. Its purpose is not to disclose what the proposal trustee thinks is good or appropriate. All the trustee can do with respect to the initial cash flow statement is say that "yes, these are cash flow statements", which are hypothetical projections. The trustee's signature is compelled by statute, but there has been no impartial review by the trustee, and thus an unrealistic statement can undermine immediately the legitimacy of the trustee.

If the trustee prepares a detailed analysis as part of its report back to the court at the end of the initial thirty day stay period, at that point, the trustee may be saying things that are not in concert with the debtor, which are based on its own professional views of projected cash flows.

Some participants contrasted the *BIA* proposal process with the *CCAA*, where the debtor gives its cash flow statements as an affidavit and then thirty days later the monitor gives a report. In the *BIA*, the trustee only has ten days to sign off on the cash flow and the view of practitioners was that it can taint the perception of the trustee's impartiality by the time it gets to its thirty day report. One trustee in Calgary observed that his firm gets calls to file an NOI in 24 hours and the trustee knows the cash flows are bogus, and then in thirty days it must come back and advise the court that it was misinformed. Participants were unclear what benefit is being achieved in having the trustee sign off on the hypothetical cash flows after ten days. One solution would be to have the debtor sign off, but not the trustee, since no creditor is comforted by the trustee's statement, or if the creditor is new to the process, it might be misled by the statement.

In Québec, the trustees are expected to give *viva voce* evidence and explain their report and answer questions in court. Some welcome this opportunity because it allows them to say "here is what I really think as an officer of the court." The opportunity for the trustee to explain its view was viewed by some participants as a good idea, because the trustee has to meet the concern that it is working for the debtor.

One recommendation was that the initial cash flow statement should be solely the company's document; and then there could be an obligation for the proposal trustee to look at it and decide if it made any sense. However, in Halifax and Vancouver, it was noted that often the financials are in very bad shape and there is either no financial statement or there is insufficient information to discern a preliminary cash flow statement. In Halifax, one practitioner observed that at the lower end of Division I proposals, there is a particular issue regarding accuracy of the financials.

A number of people across several cities suggested that it would be preferable if the debtor filed the cash flow projection at the same time that it files the stay application. The trustee should only be required to comment on the cash flow at the come-back hearing. The view of one practitioner was that "If debtors truly think they are going to restructure and convince the creditors, let them fall on their own sword."

Another suggestion was to give secured creditors the ability to ask the proposal trustee to comment on the cash flows at the outset of the proceeding. For example, in one case, the trustee saw an officer of the debtor spending $350 per day in meals and entertainment, and it was blamed as the trustee for a cash flow like that, even though it had not been involved in its drafting.

ii. Wage and Pension Claims in Proposals

Section 60(1.3)(a) is aimed at ensuring that unpaid wage claims are satisfied in a proposal. The pension payment is required as a condition of ratification of a proposal. However, wage earners in proposals are not entitled to payment under the new Wage Earner Protection Program (WEPP) because the program only contemplates payments in the case of bankruptcy or receivership of the employer.[146] The employee wage protection reform in the *BIA* and *WEPPA* was intended to ensure consistency of treatment between wage earners whose employer becomes bankrupt or is put into receivership and wage

[146] The *Wage Earner Protection Act* was part of the insolvency law amendments that came into force July 7, 2008, Statutes of Canada, c. 36.

earners whose employer undergoes a restructuring, but does not fully accomplish this objective.[147]

The amendments also create a new priority for specified claims related to pensions that must be included in a proposal. Pension rights can form a significant portion of a wage earner's compensation from the employer, although it is deferred income. For wage earners, a diminution of pension benefits will have a negative impact on future income levels. The reform is aimed at providing a higher priority for unremitted pension contributions. The amounts subject to the priority are: contributions deducted from employees' salaries but not remitted to the pension fund, contributions owed by an employer for the cost of benefits offered under the pension plan, excluding amounts payable to reduce an unfunded pension liability, and contributions owed by an employer to a defined contribution plan.[148] If an unfunded pension liability exists and a claim is made, it is treated as an unsecured debt. Because court approval is required before a Division I proposal is finalized, prohibiting a court from approving any proposal that does not require the payment of unremitted pension contributions described above effectively grants a super-priority to the pension contribution amounts. The super-priority, however, is limited by the operation of s. 60(1.6), which provides flexibility for the court to allow for a compromise of pension contribution obligations where the parties agree and the pension regulator approves.[149]

In terms of defined contribution plans, if the debtor did not make the required contributions, they are not treated as a priority. The level of benefit in the future is determined by the level of contribution and the earnings while the money is in the plan. For defined benefit plans, the fact that the debtor employer did not make the contributions does not affect the ultimate obligation to pay, but it does affect the fund's ability to make good on the employer's promise. Even if there was a higher priority for unpaid contributions, there could still be a lower pension because solvency deficiencies have no

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[147] For a full discussion, see Jean-Daniel Breton, "Employee Protection in Insolvency Proceedings – Reviewing the Performance and Setting the Objectives", in *Annual Review of Insolvency Law, 2010* (Toronto: Carswell, 2011).

[148] Obligations relating to unfunded pension liabilities, including special payments or solvency payments ordered to be paid by a regulator but not remitted to the pension fund, were not given a higher priority.

[149] The amendments to sections 50 to 62 are aimed at encouraging debtors to use the proposal provisions of the *BIA.* The amendment to s. 62(1) is intended to clarify the documents that have to be filed with the official receiver by the trustee. The amendment to s. 62(2) and the addition of s. 62(2.1) are intended to ensure that s. 178 protection is lost only if the creditor votes in favour of the proposal and the proposal explicitly provides for the compromise of the s. 178 claim. The potential has existed for s.178 creditors to inadvertently release claims by accepting a proposal; the new wording in s. 62(2.1) is aimed at correcting any ambiguity. The nature of pension regulation in Canada also affects aspects of the section; pensions may be regulated federally or provincially and the section captures pensions described in both federal and provincial legislation.

priority claim. They have nothing to do with unremitted contributions because they are a result of actuarial calculation, less income earned than predicted, and what it actually costs to provide the benefit. There is no compromise available of the pension benefit promised, benefits accrued cannot be reduced. However, future benefits or the length of time to pay the solvency deficiency and can be compromised in a proposal.

Participants at the public meetings observed that trustees and receivers are facing some of the same issues under these provisions as discussed above in the context of the *CCAA.* However, problems are relatively infrequent because the majority of smaller debtors do not offer pension or benefits plans to their employees.

iii. Collective Bargaining Provisions

For unionized insolvent debtor companies, there are now provisions confirming that collective agreements remain in force and providing for collective bargaining during a proposal proceeding, aimed at creating certainty for unionized workers and debtor companies that are unionized. A debtor may apply to the court for an order authorizing the debtor to serve a "notice to bargain" under applicable provincial or federal labour laws to the union's bargaining agent.[150]

Participants at the meetings generally expressed the view that they have not encountered problems with these provisions, and any uncertainty that they thought might occur, has not really appeared.

iv. Director Indemnification and Replacement

The new section 64(1) specifies that the court, on the application of any interested person, may make an order removing a director from office if the court is satisfied that the

[150] *BIA,* s. 65.12(1). A court order will be required because labour law stipulates specific periods when a notice to bargain may be served. Subsection (2) sets out the conditions that must be met before a court may grant the order. The debtor may continue to negotiate with other parties and may prepare a proposal to bring to its creditors before the time periods set out in the relevant labour law expire. Subsection (3) provides that the vote of the creditors in respect of the proposal may not be delayed solely because the period provided under the relevant collective bargaining process has not expired. Subsection (6) clarifies that the existing collective agreement remains in force unless the debtor and the bargaining agent have agreed to revise its terms. Section 65.12(4) provides the bargaining agent with a claim against the debtor for the value of any concessions granted during negotiations with the debtor. The claim would be as an unsecured creditor. Section 65.12(5) specifies that a bargaining agent may apply to the court for an order compelling a person with information regarding the debtor's business and financial affairs to provide that information to the bargaining agent that is relevant to the collective bargaining. Section 65.12(6) is intended to clarify that the court does not have the authority to unilaterally impose an amended collective agreement on the parties.

director is unreasonably impairing or is likely to unreasonably impair the possibility of a viable proposal being made in respect of the debtor or is acting or likely to act inappropriately as a director in the circumstances. The court is authorized to fill any vacancy created by an order made under s. 64(1).[151] Participants reported that they have not had any experience with this provision.

The amendments also codify the court's ability to order indemnification for directors during proposal proceedings. Directors are confronted with statutorily created personal liability, including for unpaid wages and taxes, when the business they are engaged by suffers financial difficulties. Some statutory liabilities provide for a due diligence defence, but not all. There is a risk that directors will resign rather than accept additional potential liability, leaving the business without experienced direction.[152] The recent reform provides directors and officers with greater protection against personal liability that may arise due to circumstances beyond their control in an insolvency proceeding, by providing them with indemnification under specific circumstances for "post-commencement" liabilities.

More directors may be willing to continue to act, thereby increasing the potential for successful proposals. Pursuant to s. 64.1(1), the court now has express authority to make an order declaring that all or part of the property of the debtor is subject to a security or charge in favour of any director or officer, to indemnify the director or officer against obligations and liabilities arising after the filing of the notice of intention or the proposal. The court may not make the order if, in its opinion, the debtor could obtain adequate indemnification insurance for the director or officer at a reasonable cost. The court may order that the security or charge ranks in priority over the claim of any secured creditor.[153] Realistically, it may be available only to larger businesses, as the court may not grant the charge if the director has other personal incentives to remain. The court is to make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if, in its opinion, the liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Québec, the director's or officer's gross or intentional fault.[154]

Participants at the public meetings reported that they have used the indemnification provisions for some mid-market files, and that there have not been any substantive or practice issues.

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[151] *BIA,* s. 64(2).
[152] "Failure to Capture the Brass Ring", *supra*, note 135 at 64.
[153] *BIA,* s. 64.1(2).
[154] *BIA,* s. 64.1(4).

v. Critical Suppliers

As part of the restructuring tools implemented in the last reform, a provision was introduced in the *CCAA* to compel critical suppliers to deliver goods and services, even on credit, on such terms as the court finds appropriate, provided only that if the supplier is required to deliver on credit, the court must order a charge to protect the supplier for the post commencement credit.[155] An equivalent provision was not introduced in the *BIA*; and the public meetings discussed whether or not such a distinction is warranted, with most participants of the view that such a provision in the *BIA* would be very helpful in proposal proceedings.

vi. Liability Waivers

Under the *BIA*, there is very limited possibility to release third parties from liability. Section 62 *BIA* provides that a proposal is binding only in respect of secured and unsecured claims against the debtor, and the proposal does not release debts referred to in s. 178 *BIA* (with an exception), and does not release a person who would not be released by a discharge. Section 179 specifies that an order of discharge does not release a person who was jointly bound with the bankrupt.[156] The only exception is the possibility to release directors from statutory liability, under section 50(13).[157]

The prohibition included in the *BIA* and the exercise of judicial discretion in the *CCAA* result in a different treatment between the two main restructuring statutes; yet a number of participants observed that such a distinction is warranted as the codification under the *BIA* gives greater certainty. However, other participants at the meetings argued for a tightening of liability releases under the *CCAA*, to align with the *BIA.*

In Montréal, one practitioner's view was that in the *Mansfield CCAA* matter, the banks received a free pass; he observed that he understood the business issues, but he was concerned that every time someone is potentially liable, the price of their participation will be that they are released from any obligations.[158] One suggestion in Montréal was to clarify the statutory language to require consideration for any release, with high thresholds and clearly articulated criteria. Others observed that there is a policy decision under the *BIA* to exclude the benefits of the proposal to extend to third parties, and yet

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[155] *CCAA,* s. 11.4.
[156] *BIA, s. 179.*
[157] *BIA, s. 179.*
[158] *Re Metcalfe & Mansfield Alternative Investments II Corp.*, Ontario Superior Court, File #: 08-CL-7440, Court of Appeal, File #: C48969, M36489.

that policy has been ignored, in favour of releases, contravening the statute. In Halifax, practitioners also reported that third party releases have become a problem due to too much pressure, leaving claimants inappropriately less protected.

vii. Disclaimer of Agreements

Among the obligations that the debtor may seek to renegotiate are ongoing agreements. The debtor is now able to unilaterally terminate or disclaim agreements, subject to specific limitations.[159] Section 65.11 allows debtors to shed contracts where it will enhance the prospect of a viable proposal. Certain agreements may not be unilaterally disclaimed by the debtor, including eligible financial contracts; collective agreements; financing agreements if the debtor is the borrower; or a lease of real property or of an immovable if the debtor is the lessor.[160] Third parties have the right to challenge a disclaimer by application to the court.[161] The amendments set out the factors that the court is to consider in determining whether or not to grant the declaration, specifically, among other things, whether the trustee approves of it; whether the disclaimer or resiliation would enhance the prospects of a viable proposal; and whether it would likely cause significant financial hardship to a party to the agreement.[162] One question raised at the public meetings was whether the drafters should have considered criteria that had the court determine what is fair and reasonable in the circumstances.

An agreement is disclaimed or resiliated if no application is made 30 days after the debtor gave notice; or if the court dismisses an application after the same period or any later day fixed by the court; or if the court orders that the agreement is disclaimed or resiliated.[163] If the debtor has granted a right to use intellectual property to a party to an agreement, the disclaimer or resiliation does not affect the party's right to use the intellectual property, including the party's right to enforce exclusive use during the term of the agreement for any period for which the party extends the agreement as of right, as long as the party continues to perform its obligations under the agreement in relation to the use of the intellectual property.[164] If an agreement is disclaimed or resiliated, the party that suffers a loss in relation to the disclaimer or resiliation has a provable claim.[165] A debtor must, on

[159] *BIA,* s. 65.11.
[160] *BIA,* s. 65.11(2).
[161] *BIA,* s. 65.11(3).
[162] *BIA,* s. 65.11(5).
[163] *BIA,* s. 65.11(6).
[164] *BIA,* s. 65.11(7).
[165] *BIA,* s. 65.11(8).

request by a party to the agreement, provide in writing the reasons for the proposed disclaimer or resiliation within five days after the day on which the party requests them.[166]

Generally, the view was that the disclaimer provisions are quite streamlined and effective. One practitioner noted that a problem that has arisen is that the provision says that the landlord cannot disclaim its lease. There is no similar provision about a lessor for a personal property lease. This problem arises in respect of securitization of motor vehicle leases. The rating agencies want to know that they will not be disclaimed; and trustees suggested it would be helpful to have some real certainty.

In Vancouver, practitioners observed that they have used the provisions, and that usually disclaimers are uncontested. Given how recent the amendments are, most trustees felt there was not yet enough experience with the provisions to comment on their effectiveness. One issue identified at the Vancouver meeting was that creditors can disclaim without looking at how it affects the restructuring. In Calgary, the view from a number of practitioners was that the disclaimer provisions work well as the process is streamlined and relatively effective.

Yet one observation was that in our effort to restructure businesses, we allow the debtor a lot of leeway to resiliate or transfer contracts. This process may simply shift the burden inappropriately to creditors. One practitioner observed that there could be better account made of the impact of the change on the co-contracting party. The debtor has a lot of ability to transfer contracts, but there was concern that the insolvency system is becoming a "debt-washing machine". One option suggested is to restrict the changes to agreements to situations where a proposal would be impossible absent the resiliation, providing the court adequate information to make that assessment.

viii. Provisions for Effective Participation

Section 64.2(1)(c) of the *BIA* was added to allow for effective participation of interested stakeholders, either directly, if they are large creditors, or indirectly as part of a creditors' group or stakeholders' group in proposal proceedings. The court has authority to grant certain parties a priority charge over the assets of a debtor if the court determines it is necessary for effective participation in the proposal proceedings.[167] The court has

[166] *BIA,* s. 65.11(9).
[167] *BIA,* s. 64.2(1). The court may make an order declaring that all or part of the debtor's property is subject to a security or charge, in an amount that the court considers appropriate, in respect of the fees and expenses of (*a*) the trustee, including the fees and expenses of any financial, legal or

authority to order that the security or charge rank in priority over the claim of any secured creditor of the debtor.[168] The court may not make the order in respect of an individual debtor unless the individual is carrying on a business; and only property acquired for or used in relation to the business may be subject to a security or charge.[169]

Participants at the public meetings discussed the changing nature of creditors' committees. As in *CCAA* proceedings, trustees are seeing more informal committees in *BIA* proposal proceedings. The general view was not to codify the practice, given that they add a huge amount of cost in the United States. One practitioner observed that sixty percent of the litigation in the US is based on creditor committees.

One participant observed that in one proceeding in 2000, there was $100 million in unsecured debt and a creditor committee was appointed by the court. It was a very active committee and creditors received a return of 82 cents on the dollar. The committee was very aggressive on claims and getting receivables on real estate. In that case, the secured creditors clearly were going to have all their claims met, so it was helpful that the unsecured creditors drove the process to maximize the value of the assets. The court also approved the funding of the committee, which was effective.

Another view was that the proposal trustee represents the unsecured creditors, and while occasionally such committees can assist where the file is complex, usually there are not enough assets to support such a committee. One of the complaints in the Ontario cases is that the unsecured creditors committee is funded by the US debtor's estate and the lack of cost consequences means that issues that should be negotiated are being litigated instead.

ix. *Ipso Facto* Clauses

Amendment to s. 65.1(1) of the *BIA*, effective July 7, 2008, clarified that the protection against the impact of *ipso facto* clauses, which purport to entitle the termination of an agreement on the basis of the filing of a notice of intention or a proposal, also applies to security agreements. This change was aimed at ending abuse of *ipso facto* clauses, where contracts may be cancelled only because of the insolvency filing, and not for any

other experts engaged by the trustee in the performance of its duties; (*b*) any financial, legal or other experts engaged by the person for the purpose of proceedings; and (*c*) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for the effective participation of that person in the proceeding.

[168] *BIA,* s. 64.2(2).

[169] *BIA,* s. 64.2(3).

breach in performance of the contract. One issue raised at the meetings was why the issue of payment of arrears is only mentioned in respect of rent, royalties or public utility charges.

x. Sale of Assets

The 2009 amendments were aimed also at providing the debtor with greater flexibility in dealing with its property while limiting the possibility of abuse. A debtor filing a proposal or notice of intention may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court.[170] The court can authorize the sale or disposition even if shareholder approval was not obtained. In the case of an individual who is carrying on a business, the court may authorize the sale or disposition only if the assets were acquired for or used in relation to the business.

Applications under this section require notice to the secured creditors that are likely to be affected by the proposed sale or disposition. In deciding whether to grant the authorization, the court is to consider, among other factors, whether the process leading to the proposed sale or disposition was reasonable in the circumstances; whether the trustee approved the process leading to the proposed sale or disposition; whether the trustee filed with the court a report stating that in its opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy; the extent to which the creditors were consulted; the effect on the creditors and other interested parties; and whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.[171]

Section 65.13(5) addresses the situation where the proposed sale is to a related person. If the proposed sale or disposition is to a person who is related to the insolvent debtor, the court may, after considering the above-noted factors, grant the authorization only if it is satisfied that good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the insolvent person; and the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition. For purposes of this section, a related person includes a director or officer of the debtor, a person who has or has had, directly or indirectly, control in fact of the debtor, and any person who is related to any of these people.

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[170] *BIA,* s. 65.13.
[171] *BIA,* s. 65.13(4).

The court may authorize a sale or disposition free and clear of any security, charge or other restriction and, if it does, it is to order that other assets of the debtor or proceeds of the sale or disposition are subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.[172] The court may grant the authorization only if the court is satisfied that the debtor can and will make the payments that would have been required under ss. 60(1.3)(a) for wage claims and (1.5)(a) for specified pension claims if the court had approved the proposal.[173]

The amendments were designed to facilitate business proposals while offering some fundamental protections for creditors from potential abuses of proposal proceedings. Practitioners did not report any problems with these provisions at the public meetings.

xi. Initial Changes to Consider

1. *Consider statutory language requiring that proposals presented to creditors must specify how the causes of the insolvency are being addressed in the proposal.*

2. *Consider a statutory amendment that would restrict changes to contracts by the debtor to instances where a proposal would not be possible absent transfer or repudiation of the contract.*

3. *Have the debtor file an initial cash flow statement at the time of filing the NOI and the proposal.*

4. *Change the current requirements to have the principals of the debtor company sign off on the initial cash flow statements instead of the trustee.*

5. *Authorize the trustee to have full access to financial information at the outset of the proceeding and have it report to the creditors and the court, within a specified period, such as 10, 20 or 30 days.*

6. *Enact critical supplier provisions in the BIA similar to the provisions in the CCAA.*

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[172] *BIA,* s. 65.13(7).

[173] *BIA,* s. 65.13(8). Pursuant to section 66(1.1), in deciding whether to make an order under subsection 84.1(1), the court is to consider, in addition to the factors referred to in subsection 84.1(3), whether the trustee approved the proposed assignment. Section 66(1.3) specifies that for the purposes of subsection (1), the examination under oath by the official receiver is to be held, on the attendance of the person in respect of whom a notice of intention or a proposal is filed, before the proposal is approved by the court or the person becomes bankrupt.

6. The *Wage Earner Protection Act*

The *Wage Earner Protection Program Act (WEPPA)* was aimed at addressing immediate hardship faced by employees of insolvent companies when they experienced loss of outstanding wages and some specified benefits such as vacation pay owing. The goal was timely payment of their claims, to a specified cap, with the federal government then able to pursue the claims within the insolvency or bankruptcy proceeding. Practitioners at meetings right across Canada observed that the original idea of the *WEPPA* was very straightforward, but the system of administration is complex, cumbersome, untimely and expensive.

A myriad of problems were identified. Trustees advised that they want to be in a position to pay employees on a timely basis. However, in some instances, the bank has forwarded the payment, but it hasn't gone out to the employees for an extended period because of federal government administration deficiencies.

In Halifax, participants observed that the cost of processing *WEPPA* claims has been exorbitant; and that trustees have had inconsistent advice as to whether *WEPPA* applies on sale of a business. One trustee observed that Human Resources and Skills Development Canada (HRSDC) has improved somewhat in its administration, but that considerably more clarity is required in processing claims.

One very important issue identified was employee rights after a proposal fails due to default by the debtor. Employees in a number of cases have missed the deadlines for *WEPPA* because the proposal was undertaken by their employer. A number of practitioners suggested an extension mechanism is needed to ensure that these employees are not disenfranchised.

One participant pointed out that the original theory of *WEPPA* was that it would cost nothing to the government, since it would get paid through subrogation of employees' claims under section 83.1 and 83.4. Yet *WEPPA* is indexed whereas the priority for the wage claims under the *BIA* is not, leaving a gap that should be remedied. One practitioner observed that the cost to the government in 2009 was approximately $35 million in pay-outs under *WEPPA*, suggesting that the amount will most likely grow unless the government gets better at retrieving funds as part of the insolvency proceeding. Trustees observed that when the employees aren't paid, it is typically the smaller

companies; and thus while the government is recovering some value, the assets just aren't there to fully recover costs.

One trustee observed that it is generally relatively easy to calculate how much compensation employees are owed, but then former employees come out of the woodwork wanting a common law claim. Other participants at the meetings suggested that their experience has been that it is not very clear from a practical perspective how it works; and that it should be easy to calculate pay claims, but they get complicated because of the myriad types of employment.

In Vancouver, a significant issue in respect of the *WEPPA* and its relationship with the *BIA* is that the superintendent is withholding comment letters because its staff are not sure if it is a disbursement or a dividend to the employees, which delays the process. The trustees observed that it is a levy issue, the trustee has paid a *WEPPA* claim but the OSB is taking the view that it is a dividend. If the levy is applicable, the trustee does not know how to get the money back. Service Canada has been really unresponsive and unhelpful and the view was that it tends to "nickel and dime" the trustee. The trustee has to pay OSB and then Service Canada. Trustees are entitled to seek direction from the court if they need it. One suggestion was to ask the OSB to expedite the comment letters. Another suggestion was to clarify that the levy is not payable, as it is not a dividend.

There was considerable concern expressed regarding what value the trustee community is giving to the *WEPPA* program, given that much is a duplication of the government's administrative effort. Several practitioners observed that for the amount of costs that are being pushed through to other parties, the benefit is questionable.

The trustees are basically responsible for the calculations of all the amounts. The delay happens when the trustee must wait for Service Canada to send out the subrogation letters. There is a requirement to pay employees within a certain period of time, but delays by the federal government create delays for trustees. One suggestion was that the legislation could clarify that the subrogation is automatic and does not need individual consent, and then once the trustee does the calculations, Service Canada could determine how much would be paid out; it would be much easier than waiting for the subrogation letters.

The view across Canada was that the inclusion of the *WEPPA* duties has created a significant layer of additional complexity in trustees' administration of the estate.

Employees are a special group of creditors with varying degrees of sophistication, and trustees are dealing with claims at a time that the employees are experiencing high levels of stress.

From a cost perspective and simplicity perspective, one trustee thought that it may make more sense just to say that the payments of wages are wages and accrued vacation. He believes that the decision in *Leroy* to include benefits made it more complex. Others disagreed and voiced the view that the judgment had helpfully clarified the scope of claims. Another participant observed that another example is Pacific Blue Cross having to file a line by line accounting of benefits. The intention of the legislature was to lessen the impact of insolvency on the employees, but the majority of participants at the meetings noted that the *WEPPA* procedure doesn't do that. Employees might get their money, but it is very hard for them to understand their rights.

Other participants at the public meetings observed that employment insurance reporting is a big burden on the trustees. They must go to the employee's new Employment Insurance office, even if the trustee doesn't know that the employee has moved. The idea is to ensure that the government isn't overpaying benefits, but the administration is highly labour intensive. One practitioner observed that summary statements don't say what is secured and unsecured. She reported that the government says it tells the individual employee the difference and the trustee must collect those letters.

Another problem identified is that when the trustee receives a letter from HRSDC, there is no case name, and the trustee has to go and match the number up to the case, which multiplied by hundreds of thousands of employees is very time consuming. A standardized identification number would be really helpful.

In Calgary, participants observed that the process of trying to figure out who is owed money in a situation where there are 200 or more employees is difficult. In one file, some employees were paid a living out allowance in lieu of overtime, some were paid overtime, some had not been paid for six weeks, and some were seasonal. The trustee walked in, had the keys thrown at it, and everyone left; the trustee found that the employees were being paid from a secret bank account. There was a cost that was incurred to just figure out who was owed money.

Trustees reported that when they start to file claims, Service Canada will send the trustee a letter with the monthly payout but not the breakdown. There is a huge reconciliation

task in discerning who was paid. They observed that there have been instances where the federal government paid out claims to non-eligible employees or paid claims from wrong estate; and there have been disputed claims where they just pay without disclosing what is disputed. One trustee suggested that Service Canada could use its information to send the trustee a statement of what and who is actually being paid.

Another suggestion at the public meetings was to change the procedure to have the trustee do all the administration, send the cheques to employees, and then just submit a bill to HRSDC, given that the trustee is doing 98% of the work anyways. That idea received support with the caution that *WEPPA* administration is expensive, and the compensation would have to be fair. However, one participant pointed out that it might impose too great a burden on a small practitioner. At the Calgary meeting, trustees advised that the problems are that the trustee must do all the administrative work; it is very labour intensive and fees are inadequate; there is personal liability for the trustee; and there is a forty-five day limit to file the claim, but *WEPPA* pays out claims six months or more later.

A variation on that suggestion was to change the procedure to have the trustee or receiver simply certify what is owed to the employee based on the payroll records, and then the trustee or receiver could requisition a cheque from the government. For the vast majority of employees, that amount will be accurate and thus most of the administration would be eliminated. There could be a streamlined appeal for employees who believe they are entitled to a greater amount.

One trustee observed that his firm’s practice is to send employees a completed claim absent their signature and wait for it to be returned. The trustee pays the claim out of the current assets, reflected in Schedule A, and this practice hasn’t caused his firm a problem. Another trustee also advised that she calculates it, sends it out and waits for the employees to return it.

Another problem that the employees encounter is that trustees often won’t file the claims with *WEPPA* until they get a substantial number of the claims back, which delays payments to employees. One issue is that the employees typically don’t know what they are owed, so they have to come to the trustee anyways. One trustee pays it out, calculates it, and advises the government so the employee isn’t paid twice. A number of participants suggested that we need to develop some uniformity in the practices, as everyone has tried to streamline given the Service Canada has not.

Others observed that trustees have refused cases because of the *WEPPA* issues, where it is too much work and there is not enough money to pay the trustee. In Toronto, trustees remarked that the concept of *WEPPA* is great, but they've made it so complicated to administer that it is becoming a disaster; and that often, by the time the money gets to the employees, they have moved and are hard to locate. In the Ontario region, payouts from *WEPPA* are taking up to six months, causing hardship for employees. Yet if the receiver or trustee pays the wage as part of administration of the estate, it reduces the *WEPPA* amount for the employees.

Another issue identified was when a receiver continues employment for a period of time before the business is shut down; receivers have been told that in that situation the employees are not eligible for *WEPPA.*

A further problem raised at the Toronto meeting is that the federal government has, after employment insurance claims payouts, clawed back *WEPPA* payments. The government takes the position that if there is money from the *WEPPA,* the employee has to repay some unemployment insurance. There needs to be clarification as to the difference between wages owed for past service and entitlement to employment insurance.

Another recommendation raised at many meetings was to have the time period and the amount of money, including the inflation adjustment, in the *WEPPA* mirrored in the *BIA* priority provisions.

Overall, trustees observed that we don't have the appropriate statistics to determine whether *WEPPA* is effective, but many felt that to date it is unworkable, expensive, and does not necessarily achieve its goals.

i. Initial Changes to Consider

1. *Simplify the administration of WEPPA claims and make practices consistent across Canada.* A number of very practical suggestions were made at the public meetings as to how administration could be made more effective and less administratively costly. HRSDC should take the advice of the trustee community as to how to make the system of administration more timely, fair and efficient.

2. *As one option, consider having an administrative system whereby the trustee certifies what is owed to each employee based on the payroll records, and then have the trustee requisition a cheque from the government and make the payouts. There could be a streamlined appeal for employees who believe they are entitled to a greater amount than the cheque they receive.*

3. *Consider amendments to the BIA to align the priority amount of wage and benefit claims to the indexed amount under the WEPPA.*

4. *Clarify that time periods for employees do not run during the period that a proposal is in place, allowing employees full rights to payment under the WEPPA if a proposal fails.*

5. *Consider enacting language to allow employees to be eligible for WEPPA payments if a receiver operates a business for a period and then it closes down, even if the eligibility is limited to pre-receivership amounts owing.*

6. *Enact statutory language to prohibit employment insurance claw backs for amounts paid out under the WEPPA program for past performance.*

7. *Considering implementing a standardized identification system for individual employees, to facilitate processing of payments, simplify employment insurance reporting and reconciliation of records.*

8. *Clarify that there should be no OSB levy on payments under the WEPPA.*

IV. CONCLUSION

There are far too many issues canvassed above to summarize them in a conclusion. But it is fair to suggest that there are several broad themes that resonate throughout the report and that animated many of the discussions held across Canada. First, there is an interest in articulating the social goals that underpin Canadian insolvency proceedings. While there was almost unanimous agreement that the courts have done a good job of balancing diverse interests and recognizing that insolvency law engages multiple types of creditors and other stakeholders, the public interest and the social policy that underlays Canadian law, there was concern that aggressive foreign creditors will chip away at that framework absent some codification of the express objectives of the legislation.

Second, it is very clear that the *CCAA* is not as effective as it could be for mid-market debtor companies and that there could be some relatively simple changes to facilitate access while still protecting creditors. Equally, it was clear at the meetings that the *BIA* proposal provisions need some retooling to address very small debtors, perhaps to introduce some procedures similar to some of the default processes allowed currently for consumer proposals.

Third, it is evident that financing workouts continues to be problematic. Issues include everything from the high cost of DIP facilities, to use of interim financing contracts to place inappropriate controls on the proceeding, to the complete lack of a DIP financing market for small businesses. While these issues are likely to be market driven, there is a role for the courts in ensuring that the terms of interim financing do not run counter to the objectives of the legislation, and to ensure that its decisions on both interim and exit financing are fair and transparent, as a signal to the market as to what is appropriate. There may also be a role for the federal government in facilitating workout financing in some instances of smaller businesses with good business plans and good management, but at risk because of uncertain market conditions.

Fourth, employees, pensioners and disabled employees continue to face tremendous problems in respect of their economic security, including issues such as priority of their claims, their vulnerability during insolvency, barriers to information and to participation, and the interface of social supports and insolvency law. Any move forward on these issues requires a more fulsome and candid policy exchange between insolvency practitioners, scholars, unions, pension advocacy groups and disability organizations.

In terms of practice issues, the report highlights a number that are important to consider. Of particular note are the serious continuing problems with the administration of the Wage Earner Protection Program, issues that could be remedied by the federal government engaging in a constructive discussion with trustees as to how to improve the timeliness and efficacy of the system. Also of note are the continuing tensions in some *CCAA* cases about the appropriate role of the monitors as impartial officers of the court, and the need to clarify the scope and limits of their role in particular circumstances.

Finally, the increased number of corporate groups that have filed under the *CCAA* and foreign legislation has raised fundamental questions about legal personality, the reach of long-arm legislation from foreign jurisdictions into domestic proceedings, the

responsibilities of directors and officers in corporate groups, the role and authority of the insolvency professionals in cross-border proceedings, and the authority of the court to resolve or determine complex sets of claims on assets located in a myriad of jurisdictions. Canada needs to continue addressing these challenges both on a case by case basis and as a much broader public policy concern.