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• SECOND CIRCUIT AND DELAWARE BANKRUPTCY COURT TAKE DIFFERENT VIEWS OF WHETHER A FOREIGN DEBTOR MUST HAVE ASSETS IN THE UNITED STATES TO BE ELIGIBLE FOR RECOGNITION UNDER CHAPTER 15 •

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• In This Issue •

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Courts in the two circuits, which saw the majority of 2013's Chapter 15 recognition proceedings, recently addressed—and came to opposite conclusions about—a novel issue: whether an entity is required to have property in the United States to qualify for relief as a debtor under Chapter 15 of the United States Bankruptcy Code. Chapter 15 is the equivalent of a proceeding under Part IV of Canada's *Companies' Creditors Arrangement Act* [*CCAA*][1] (*i.e.*, the U.S.'s enactment of the UNCITRAL Model Law on Cross Border Insolvencies). Chapter 15 was adopted in 2005; thus, case law is continuing to develop. It is noteworthy that two courts with significant dockets disagreed with one another in rulings issues less than a week apart in December 2013.

The dispute centers on the applicability, or not, of a provision not found within Chapter 15 itself, but in an earlier section of the Bankruptcy Code,

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which applies to, for example, Chapter 11 cases. Section 109(a) of the Bankruptcy Code contains a requirement that "only a person that resides or has a domicile, a place of business, or property in the United States ... may be a debtor under this title". In *Drawbridge Special Opportunities Fund LP v. Barnet (In re Barnet)* [*Barnet*],[2] the Second Circuit Court of Appeals, whose opinions are binding on the Bankruptcy Courts for the Southern District of New York, held that s. 109(a)'s eligibility requirements apply in Chapter 15 proceedings and therefore vacated an order of recognition. Less than one week later, the Delaware Bankruptcy Court in *In re Bemarmara Consulting a.s.* (Transcript; "Tr.") [*Bemarmara*][3] issued an oral ruling, holding that s. 109(a)'s requirements do not apply in Chapter 15 proceedings and granting recognition to a debtor that, according to an objector, had no assets in the United States.

Given that the majority of Chapter 15 cases, 63 per cent of those that filed in 2013 according to one source, relate to a Canadian foreign proceeding, this issue could impact Canadian cross-border insolvencies and is of interest to any Canadian company considering utilizing Chapter 15.

This article first describes at least four reasons why a company might desire to file a Chapter 15 case, even if it has no assets located in the United States, demonstrating why this issue "matters". It next sets forth the statutory provisions of the United States Code that led to the differing results in *Barnet* and *Bemarmara* and then explores the reasoning of the two opinions. It concludes with practical observations about the availability of Chapter 15 relief for companies without significant assets located in the United States.

Situations Where Chapter 15 Relief Is Desirable Even without Assets Located in the U.S.

One might wonder: is this much ado about nothing? Do entities without assets located in the United States need Chapter 15 relief? The fact that two opinions were issued in rapid succession last December demonstrates that foreign representatives often need such relief. *Bemarmara* likely presents the most frequent scenario: litigation was pending in the United States so application of the United States' automatic stay was desirable, and the foreign representative contended that it had an intangible asset located in the United States, but the other party to the litigation disagreed. (In an alternative holding, the *Bemarmara* court agreed with the foreign representative that the intangible asset was located in the United States.) Vendor contracts regularly contain forum selection clauses, as was the case in *Bemarmara*, so numerous companies potentially could be subject to litigation in the United States, even if they have no assets located in the United States. The need to stay any such lawsuit undoubtedly will continue to be a key issue in cross-border insolvencies.

An entity without assets located in the United States might also need Chapter 15 relief when its affiliates have sought Chapter 15 relief, particularly when such affiliates have intercompany receivables. Take, for example, two affiliated debtors in a *CCAA* case: Debtor A, which has assets located in the United States, and Debtor B, which does not. Imagine then that Debtor B holds a significant intercompany receivable payable by Debtor A. Debtor A would be eligible for relief under Chapter 15. Under the ruling in *Barnet*, Debtor B would not, and suits against it—which perhaps were filed by zealous plaintiffs suing every entity they could find with a similar name and asserting veil piercing and alter ego theories—would not be stayed. Creditors could therefore pursue actions against Debtor B and, if successful, try to satisfy the judgment by asserting a right to the intercompany receivable.

Relief under Chapter 15 might also be beneficial when the foreign representative needs broad-based United States style discovery. For example, it might be seeking to determine whether the foreign debtor, or a party in litigation against the foreign debtor, fraudulently conveyed or concealed assets in the United States. Or, it might believe it has a claim, but needs discovery to determine if there is a good faith basis to assert it. Alternatively, it might desire types of discovery available in the United States but not elsewhere. Pursuant to s. 1521, upon recognition, the court may "provid[e] for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities".[4] In addition, if recognition is granted, "the foreign representative may apply directly to a court in the United States for appropriate relief in that court".[5] Thus, recognition under Chapter 15 can provide an avenue for obtaining discovery in the United States. It should be noted that there are some limits to the tactic of filing a Chapter 15 case to obtain discovery. Some U.S. courts have refused to grant recognition if the discovery sought would violate laws, public policies, or rights of citizens of the United States.[6] Further, in *Barnet*, the Second Circuit noted that "28 U.S.C. § 1782(a) provides for discovery in aid of foreign proceedings without any requirement akin to Section 109(a)", suggesting that recognition might not be necessary for the foreign representative to take discovery in the United States.[7] Section 1782 is not related to insolvency proceedings and is interpreted very broadly.[8]

Another situation when Chapter 15 relief might be desirable even without assets located in the United States occurs if the foreign representative needs injunctive relief against persons or entities located in the United States regarding non-U.S. assets.[9] For example, the foreign representative might need relief from a U.S. court to compel or enjoin certain actions of a U.S. company beyond the jurisdiction of the foreign court. Another example is a desire for an order preventing the destruction of documents needed in the foreign proceeding or the transfer of assets related to the foreign proceeding.

Relevant Statutory Provisions

Chapter 15 of the Bankruptcy Code was enacted in 2005. It adopted, nearly verbatim, the Model Law on Cross-Border Insolvency (the "Model Law") promulgated by the United Nations Commission on International Trade Law (UNCITRAL) and replaced the prior procedure for ancillary cases of foreign debtors under former s. 304 of the Bankruptcy Code.[10] Indeed, Chapter 15 appears to comport more closely to the Model Law than does Part IV.[11]

At the same time, Congress amended 11 U.S.C. § 103(a) to state, in relevant part, that "this chapter appl[ies] in a case under chapter 15". In the parlance of the Bankruptcy Code, a "chapter" is the sub-section of the Bankruptcy Code within a grouping of 100. For example, "Chapter 11" simply means ss. 1101–1174 of the Bankruptcy Code. Thus, s. 103(a) is contained in Chapter 1. This gives rise to an argument that s. 109(a)'s eligibility requirements apply in Chapter 15 cases because s. 109 is part of the "this chapter"—Chapter 1—to which s. 103(a) refers.

However, interpreting s. 109(a)'s eligibility requirements to apply in Chapter 15 cases causes significant tension with other sections of Chapter 15 itself as well as the venue statute for Chapter 15 cases, 28 U.S.C. § 1410, which support an interpretation that a Chapter 15 debtor need not have assets, a place of business, or domicile in the United States. First, s. 1502(1) provides a specific and different definition of "debtor" applicable in Chapter 15 proceedings, stating that "for the purposes of this chapter, the term—(1) 'debtor' means an entity that is the subject of a foreign proceeding".[12] Section 1502(1) does not define a "debtor" as an entity with assets located in, or a domicile in, the United States, causing an inference that there is no such requirement. Second, s. 1528 states that "[a]fter recognition of a foreign main proceeding, a case under another chapter of this title may be commenced only if a debtor has assets in the United States." This implies that a foreign debtor need not have assets in the United States for commencement of a Chapter 15 ancillary proceeding; otherwise, s. 1528 would be redundant, because a case would not proceed to recognition unless the debtor had assets located in the United States, so the "only if" language would be <u>every</u> case.

Third, and perhaps most fundamentally, 28 U.S.C. § 1410, the venue statute for Chapter 15 proceedings, seems to mandate an opposite conclusion. It provides: "A case under chapter 15 ... 11 may be commenced in the district court of the United States for the district ... (2) if the debtor does not have a place of business or assets in the United States, in which there is pending against the debtor an action or proceeding in Federal or State court".[13] If a debtor must have assets in the United States to be eligible for relief, there would be no set of circumstances where s. 1410(2) could ever be invoked, since it only applies "if the debtor does not have a place of business or assets in the United States".

Finally, the Model Law, which Chapter 15 adopts, does not contain any requirement similar to s. 109(a).[14] There does not appear to be any legislative history suggesting a desire to depart from the Model Law on this point. In addition, the predecessor to Chapter 15, 11 U.S.C. § 304, did not contain an eligibility requirement. One would have expected that if the United States Congress had intended to depart both from the Model Law and from prior practice under s. 304, there would have been significant legislative history noting the departure and its reasoning.

The Second Circuit's Decision in *Barnet*

In *Barnet*, the Second Circuit reversed the United States Bankruptcy Court for the Southern District of New York and held that s. 109(a)'s eligibility requirements apply in Chapter 15 cases. The opinion focuses on the plain meaning of ss. 109(a) and 103(a) and rejects arguments that the consideration of the other sections, set forth above, compels a different interpretation. The Second Circuit stated that "statutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses legislative purposes".[15] The Second Circuit reasoned that because s. 103(a) states that Chapter 1 applies in Chapter 15 cases and that s. 109 is within Chapter 1, s. 109(a) must apply in Chapter 15 cases.

The appellees in *Barnet* argued that under Chapter 15, a foreign representative seeks recognition of a foreign proceeding rather than it being a foreign "debtor" that seeks relief and, as a result, there is no "debtor" before the court that must meet the requirements of s. 109(a). The Second Circuit rejected this argument, noting that "the presence of a debtor is inextricably intertwined with the very nature of a Chapter 15 proceeding, both in terms of how such proceeding is defined and in terms of the relief that can be granted".[16]

Next, the Second Circuit rejected the argument that a Chapter 15 debtor need only meet the requirements of Chapter 15's specific definition of "debtor". The court reasoned that s. 109 is not a definition, but rather an additional requirement of eligibility; the definition of debtor is contained in s. 101(13) for cases under, for example, Chapter 11, and that is all that s. 1502's replacement definition changes. Therefore, the court held that s. 109 overlaid s. 1502 in Chapter 15 cases just as it overlays s. 101(13) in cases under Chapters 7, 9, 11, 12, or 13.[17] Further, the court stated that interpreting s. 1502 to "block" s. 109 "violates the 'most basic interpretive canon […]' requiring us to interpret statutes such that 'no part will be inoperative or superfluous'".[18] (As will be noted below, this reasoning is somewhat ironic because the Second Circuit's interpretation subjects it to the same criticism, making s. 1410(2) inoperative and superfluous.)

Finally, the Second Circuit addressed contextual arguments. It rejected the argument, described earlier in this article, that the necessary implication of s. 1528 was that a foreign main proceeding could be recognized where the debtor had no assets in the United States because it states that only a subset of recognized foreign main proceedings—those where the debtor has assets located in the United States—may result in the filing of a Chapter 11 or 7 case. The Second Circuit was unpersuaded, reasoning that "Section 1528, therefore is more restrictive than Section 109" and "there is nothing contrary or disharmonious about applying Section 109(a) to Chapter 15 and then further requiring that Section 1528 is met before a case under another chapter of Title 11 may be commenced".[19] In addition, the Second Circuit rejected the argument, described earlier in this article, that s. 1410(2) compels a different result because it states that a Chapter 15 case "may be commenced" in a district where litigation is pending "if a debtor does not have a place of business or assets in the United States". The court called s. 1410(2), the venue statute, "purely procedural", and stated that "given the unambiguous nature of the substantive and restrictive language used in Sections 103 and 109 of Chapter 15 [sic], to allow the venue statute to control the outcome would be to allow the tail to wag the dog". The opinion does not grapple with when s. 1410(2) ever could be invoked under the holding of *Barnet*.

The Delaware Bankruptcy Court's Decision in *Bemarmara*

Just days after the Second Circuit issued its opinion in *Barnet*, the Delaware Bankruptcy Court was faced with the same issue in *In re Bemarmara Consulting a.s.* There, the foreign representative of a Czech Republic insolvency proceeding sought recognition of the foreign proceeding in the Bankruptcy Court for the District of Delaware, the District in which litigation was pending against the debtor. After directing the parties to submit supplemental briefing addressing the *Barnet* decision, the Delaware Bankruptcy Court issued an oral ruling disagreeing with the Second Circuit's decision. The Delaware Bankruptcy Court reasoned that s. 109(a) relates to the eligibility of "debtors" under the Bankruptcy Code, but in a Chapter 15 case, "it is the Foreign Representative who is petitioning the Court, not the Debtor in the foreign proceeding".[20] The court further relied on s. 1502(1)'s specific definition of "debtor", articulating the argument discussed above. In addition, the court noted, "Commentators have reflected on the possibility that it was a scrivener's error and that the intent was that s. 109(a) not apply,"[21] an apparent reference to the Johnston article cited above.

Impact of *Barnet* and *Bemarmara*

As a result of *Barnet* and *Bemarmara*, there is currently a split of authority regarding the application of s. 109(a)'s eligibility requirements to Chapter 15 debtors. Perhaps highlighting the tension among the various statutory provisions, as described above, each opinion contains some persuasive points. Certainly looking at ss. 109(a) and 103 in isolation, the Second Circuit's plain meaning analysis seems to have appeal. However, its holding is, as the Delaware Bankruptcy Court pointed out, "contrary to Congress's intent".[22] Moreover, the Second Circuit supports its holding with the canon of statutory construction that "statutory enactments should … be read so as 'to give effect, if possible to every clause and word of a statute'" and that statutes should be interpreted "such that 'no part will be inoperative or superfluous'",[23] but its own interpretation renders other statutes "inoperative and superfluous". Its answer that the venue statute is "purely procedural" rings hollow not only because the statutory construction canon has no "purely procedural statute" exception but also because that might not be a fair characterization of a statute that expressly authorizes a filing: "a chapter 15 case may be commenced".

As a practical matter, this split may be an issue that affects only a small minority of foreign debtors. After all, the case law under s. 109(a) (developed in Chapter 11 cases) does not place any requirement on the <u>quantity</u> of assets that must be located in the United States in order to obtain eligibility.[24] Nevertheless, the fact that *Barnet* and *Bemarmara* were both decided in December—and the other reasons why this type of relief might be sought as described above—show that this situation arises more than occasionally.

Some commentators have suggested that foreign representatives seeking recognition of foreign proceedings in the future may simply move some small amount of assets into the United States prior to filing.[25] It is unclear whether foreign representatives and foreign debtors that follow this advice and are found to have "manufactured" eligibility prior to filing will be met with resistance. While no opinion to date has examined this issue under s. 109, at least one opinion has considered a somewhat analogous issue and deemed the moving of assets shortly before filing a Chapter 15 case to be relevant to a determination of the location of a company's centre of main interest.[26] A foreign representative's ability to "manufacture" eligibility for a foreign debtor is presently at issue in the *Suntech Power Holdings, Ltd.* Chapter 15 proceeding in the Bankruptcy Court for the Southern District of New York.

Until the case law becomes more settled, foreign representatives will need to consider whether the foreign debtor has assets in the United States, and if not, in which Circuit within the United States venue might be appropriate, in determining whether relief under Chapter 15 will be available to it.

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1 R.S.C. 1985, c. C-36.
2 737 F.3d 238 (2d Cir. 2013).
3 Case No. 13-13037 (KG) (Bankr. D. Del. Dec. 17, 2013).
4 11 U.S.C. § 1521(a)(4).
5 11 U.S.C. § 1509(b)(2).
6 See, *e.g.*, *In re Toft*, 453 B.R. 186 (Bankr. S.D.N.Y. 2011) (refusing to grant recognition where the goal was to obtain discovery in violation of, among other things, U.S. wiretap laws).
7 *Supra* note 2 at 251.
8 See *Intel Corp. v. Advanced Micro Devices*, 542 U.S. 241 (2004).
9 Susan Power Johnston, "Conflict Between Bankruptcy Code §§ 109(a) and 1515: Do U.S. Bankruptcy Courts Have Jurisdiction over Chapter 15 Cases If the Foreign Debtor Has No Assets or Presence in the U.S.? (August 2008) 17 J. Bankr. L. & Prac. 5, art. 6, at 696.
10 See *In re ABC Learning Centres Ltd.*, 728 F.3d 301, 305 (3d Cir. 2013).
11 See, generally, Pamela L. J. Huff and Scott A. Bomhof, *Cross-Border Insolvencies: Comparing Chapter 15 of US Bankruptcy Code and Part IV of Companies' Creditors Arrangement Act*, American Bankruptcy Institute: Canadian-American Insolvency Symposium 2011 (noting differences between Chapter 15 and Part IV; most of the differences arose due to modifications Canada made in adopting Part IV).
12 11 U.S.C. § 1502(1).
13 28 U.S.C. § 1410(2).
14 *Supra* note 2 at 250–251.
15 *Ibid*. at 246 (internal citation omitted).
16 *Ibid*. at 248.
17 *Ibid*. at 249.
18 *Ibid*. (internal citation omitted).
19 *Ibid*. at 250.
20 *In re Bemarmara Consulting a.s.*, Tr. at 9.
21 *Ibid*.
22 *Supra* note 9 at 678.
23 *Supra* note 2 at 247 (internal quotation omitted).
24 See, *e.g.*, *In re Global Ocean Carriers Ltd.*, 251 B.R. 31, 39 (Bankr. D. Del. 2000).
25 See, *e.g.*, Debevoise & Plimpton LLP, *Client Update: Second Circuit Limits Availability of Chapter 15* (December 20, 2013), <http://www.debevoise.com/files/Publication/450255e9-004a-454f-9baa-0bd135bf6b9d/Presentation/PublicationAttachment/0a7de8a5-5dee-424b-8e31-cd55763e2a02/SECOND%20CIRCUIT%20LIMITS%20AVAILABILITY%20OF%20CHAPTER%2015.pdf>; Steven Wilamowsky and Erin Kate Mautner, *Legal Alert: Second Circuit Reverses New York Bankruptcy Court; Determines That Section 109(a) Eligibility Requirements Extend to Chapter 15 Debtors* (December 16, 2013), <http://www.bingham.com/Alerts/2013/12/Second-Circuit-Reverses-New-York-Bankruptcy-Court>.
26 See *In re Fairfield Sentry Ltd.*, 714 F.3d 127, 139 (2d Cir. 2013) (noting that the court may consider such factors to determine whether a Chapter 15 debtor's center of main interests was manipulated in bad faith).

• PROCEDURAL PROPORTIONALITY IN THE CONDUCT OF RECEIVERSHIPS: IT'S ABOUT TIME (AND COST, AND IMPACT) •

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A recent decision by Justice David Brown of the Ontario Superior Court of Justice (Commercial List) provides a timely reminder of the need for "procedural proportionality" in receivership proceedings. Justice Brown rendered his decision in connection with a receiver's motion for approval of, among other things, an asset sale and sealing order and of the receiver's fees and activities. The motion was brought in receivership proceedings involving 1262354 Ontario Inc. (the "Debtor").[1]

Overview of Facts

At the time of the Receiver's appointment, the Debtor's primary assets consisted of land and two industrial buildings located in Burlington, Ontario (the "Property"). The Debtor had unsuccessfully attempted to sell the Property for nearly a year before the court appointed PricewaterhouseCoopers Inc. as the Debtor's receiver and manager (the "Receiver").

After its appointment, the Receiver continued listing the Property for sale for a further 14 months before ultimately concluding an agreement of purchase and sale (the "APS") in respect of the Property. Subsequently, the Receiver brought a motion seeking approval of, among other things, (1) the APS and the sale transaction contemplated by it (the "Sale Transaction"); (2) a sealing order in respect of the purchase price, appraisal information, and bidding history (collectively, the "Confidential Information"); (3) approval of the fees and activities of the Receiver and its legal counsel; and (4) certain interim distributions to priority secured creditors.

The Debtor, its principal, and a subordinated creditor also owned by that principal (collectively, the "Objecting Parties") opposed the Receiver's motion. They argued, among other things, that they were unable to take a position on any of the relief sought by the Receiver without having access to the Confidential Information. The Receiver had offered to make the Confidential Information available if the recipients agreed to keep the information confidential and refrain from participating in any future Sale Process. The Objecting Parties were unwilling to accept these terms.

Access to Sensitive Commercial Information

Justice Brown rejected the Objecting Parties' argument that they should be provided with no-strings-attached access to the Confidential Information. He reasoned, among other things, that the integrity and fairness of the Sale Process would be impaired if some (but not all) participants had the benefit of the Confidential Information:

> 33 The purpose of granting such a sealing order is to protect the integrity and fairness of the sales process by ensuring that competitors or potential bidders do not obtain an unfair advantage by obtaining sensitive commercial information about the asset up for sale while others have to rely on their own resources to place a value on the asset when preparing their bids.[2]
>
> [...]
>
> 35 From that it follows that if an interested party requests disclosure from a receiver of the sensitive commercial information about the sales transaction, the party must agree to refrain from participating in the bidding process. Otherwise, the party would gain an unfair advantage over those bidders who lacked access to such information.

Accordingly, Brown J. was prepared to consider the Receiver's request for approval of the APS and the Sale Transaction without ordering disclosure of the Confidential Information to the objecting parties.

Approval of Fees and Activities

The Objecting Parties also objected to approval of the fees and disbursements of the Receiver and its counsel at the time of the sale approval. In making this objection, they relied in part on the decision of Justice Marrocco in *Bank of Montreal v. Dedicated National Pharmacies Inc.*[3] In that decision, Marrocco J. held that approval of a receiver's fees and activities should be sought "at a time that makes sense, having regard to the commercial realities of the Receivership”.[4] On the facts before him, Marrocco J. concluded that the appropriate time for seeking such approval was after the closing of a sale of the debtor’s assets.

Justice Brown declined to recognize a general rule that fees and activities should not be approved until after a sale transaction has been closed. In view of the circumstances of the case and the overarching principle of procedural proportionality, Brown J. determined that the Receiver’s motion was timely. Among other things, Brown J. focused on the following considerations.

First, taking into account the economic reality of the receivership, it made sense for the Receiver to seek approval of its fees and activities as part of its sale approval motion rather than as a stand-alone motion. Justice Brown noted the “cash-flow challenges” of the receivership and the fact that an adjournment of part of the Receiver’s motion would add unnecessary cost and delay to the conduct of the receivership—costs that would not be borne by the Objecting Parties.

Second, the Receiver’s motion materials contained detailed information concerning its fees and the fees of its legal counsel, which had been available for the Objecting Parties to review before the hearing.

Third, relatively little remained to be done in the receivership if the sale transaction was approved.

Fourth, the secured creditor with the primary economic interest in the receivership (whose priority secured claim exceeded the purchase price under the APS) had consented to the Receiver’s fees. The next-ranking secured creditor did not oppose the Receiver’s motion.

Finally, and most significantly for future cases, Brown J. referred to the principle of procedural proportionality. The Objecting Parties had been provided with adequate time in which to review the Receiver’s motion materials. Justice Brown found that the Objecting Parties had engaged in “unreasonable behavior” by refusing to agree to the Receiver’s terms for disclosing the Confidential Information and such behavior should not be “rewarded” by adjourning the Receiver’s request for approval of its fees and disbursements. Moreover, such an adjournment would increase the litigation costs of the receivership without any evident benefit. Justice Brown noted:

> In my view, courts should scrutinize with great care requests for adjournments that will increase the litigation costs of a receivership proceeding made by a party whose economic interests are “out of the money”, especially where the party is not prepared to post security for the incremental costs it might cause.[5]

Procedural Proportionality and Insolvency Proceedings

Justice Brown’s discussion of the importance of procedural proportionality references the recent Supreme Court of Canada’s (the “S.C.C.”) decision in *Hryniak v. Mauldin* [*Hryniak*]. In that case, the S.C.C. addressed a summary judgment motion in a civil proceeding and called for a culture shift to “create an environment promoting timely and affordable access to the civil justice system”.[6] In the S.C.C.’s view, this entails, among other things, the use of processes that are proportionate to the nature of the dispute and the interests involved. The S.C.C. stated:

> Even where proportionality is not specifically codified, applying rules of court that involve discretion "includes… an underlying principle of proportionality which means taking account of the appropriateness of the procedure, its cost and impact on the litigation, and its timeliness, given the nature and complexity of the litigation'.
>
> This culture shift requires judges to actively manage the legal process in line with the principle of proportionality [emphasis added].[7]

Justice Brown held:

> [l]ike any other civil proceeding, receiverships before a court are subject to the principle of procedural proportionality. That principle requires taking account of the appropriateness of the procedure as a whole, as well as its individual component parts, their cost, timeliness and impact on the litigation given the nature and complexity of the litigation.[8]

The concept of proportionality is not new to courts and insolvency practitioners, who have long been sensitive to the timelines and costs associated with insolvency proceedings. Streamlined procedures are commonly used in such proceedings to achieve timely and cost-effective resolutions of issues that may arise. For example, disputes that might otherwise form the basis of a lengthier application or a trial outside an insolvency proceeding are often resolved by motions on affidavit evidence. In such circumstances, little (if any) *viva voce* evidence is proffered and it is rare for affiants to be cross-examined on their affidavits. Similarly, the flexible and efficient approach taken to the solicitation and adjudication of claims against insolvent debtors shows the emphasis placed by all stakeholders on achieving a cost-efficient resolution of disputes.

Nevertheless, Brown J.'s call for an express consideration of procedural proportionality in evaluating the appropriateness of the (insolvency) litigation or its component parts, or of the relief sought or opposed during the insolvency process, will help participants and the court to further streamline the insolvency process with a focus on the ultimate goal of the proceeding.

Justice Brown's comments may provide stakeholders and the courts with new tools for dealing with unmeritorious or strategic motions, particularly those brought by parties with no economic interest in the proceedings. One such tool that was raised by Brown J. during the Receiver's motion is the concept of security for costs. Moreover, while the focus of this motion was on the opposing creditors, arguably the concept of procedural proportionality will apply to all parties in the proceeding, including debtors and Court Officers.

The S.C.C.'s decision in *Hryniak* and Brown J.'s decision in these receivership proceedings are helpful and timely reminders of the goals shared by all participants in such proceedings.

[*Editor's note*: **Liz Pillon** is Co-head of the Insolvency and Restructuring Group in Toronto, and **Yannick Katirai** is an Associate in the Insolvency and Restructuring Group in Toronto. Liz and Yannick acted for the Receiver of 1262354 Ontario Inc.]

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1 *GE Canada Real Estate Financing Business Property Company v. 1262354 Ontario Inc.*, [2014] O.J. No. 835, 2014 ONSC 1173.

2 *8857574 Ontario Inc. v. Pizza Pizza Ltd.*, [1994] O.J. No. 3112, 23 B.L.R. (2d) 239 (Ont. C. J.–Gen. Div.).

3 [2011] O.J. No. 165, 2011 ONSC 346.

4 *Ibid.*, para. 7.

5 *Supra* note 1, para. 50.

6 *Hryniak v. Mauldin,* [2014] S.C.J. No. 7, 2014 SCC 7, para. 2.

7 *Ibid.*, paras. 31–32.

8 *Supra* note 1, para. 48.

• PENSION PRIORITY CASES IN THE POST-*INDALEX* WORLD •

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Two recent decisions provide additional clarity in priority contests between statutory pension plan deemed trusts and secured creditors.

Two recent decisions from the Ontario Superior Court ("Ontario Court") and the Quebec Superior Court ("Quebec Court") have provided some additional consideration of pension priority issues in the insolvency context, following the Supreme Court of Canada's ("S.C.C.") landmark ruling in *Sun Indalex Finance, LLC v. United Steelworkers* [*Indalex*],[1] in February 2013. [*Editor's Note*: Another recent decision in the Quebec Court in *Re: Timminco*, discussed by Tina Hobday elsewhere in this issue, further fleshes out the position of pension plans in the post-*Indalex* world]. The recent cases address aspects of the pension priority debate alluded to, but not definitively resolved, by *Indalex*.

Reversal of Priority through Bankruptcy

Among other things, the S.C.C. held in *Indalex* that on the wind-up of a defined benefit pension plan, the deemed trust established under the Ontario *Pension Benefits Act* [Ontario *PBA*][2] secures the employer's obligation to fund the amount of any wind-up deficiency. As a consequence of s. 30(7) of the *Personal Property Security Act* (Ontario) [*PPSA*],[3] such deemed trust ranks in priority to any other security interest in accounts and inventory in Ontario. The S.C.C. held however, that in a proceeding under the *Companies' Creditors Arrangement Act* [*CCAA*],[4] the *CCAA* Court could grant interim, or "DIP" financing, in priority to that deemed trust obligation.

One of the questions that was not specifically addressed in the S.C.C.'s decision in *Indalex* was the ability of a creditor to pursue a bankruptcy order in respect of a debtor with a provincial deemed trust for purposes of "reversing" the deemed trust priority and rendering it an unsecured claim. Prior case law has confirmed that statutory deemed trusts enacted by provincial legislatures, such as that provided for under the Ontario *PBA*, can have no effect in bankruptcy because provincial lawmakers cannot purport to alter the priority regime provided for under the *Bankruptcy and Insolvency Act* [*BIA*].[5] Further, decisions rendered prior to the *Indalex* decision had held that reversing priorities by rendering a statutory deemed trust ineffective was a valid reason for a creditor to seek a bankruptcy order in respect of a debtor.

Consistent with prior case law, on September 20, 2013, in *Re Grant Forest Products Inc.* [*Re Grant Forest*],[6] the Ontario Court decided, among other things, that it was fair and reasonable to permit the lifting of a stay of proceedings under the *CCAA* in order to permit a secured lender to proceed with its application for the issuance of a bankruptcy order in respect of the debtor, Grant Forest Products Inc. ("Grant Forest Products"). The express purpose of the application was to reverse the priority of a deemed trust that had arisen under the Ontario *PBA* in respect of wind-up deficiencies in two defined benefit pension plans that had been wound up after the commencement of the *CCAA* proceedings.

Pension Priorities outside of Ontario

In *Indalex*, the S.C.C. interpreted the provisions of the Ontario *PBA* and the Ontario *PPSA* and did not expressly comment on the scope or priority of deemed trusts created by pension benefit legislation outside of Ontario. Notably, no other province has a provision similar to s. 30(7) of the Ontario *PPSA* in their personal property security legislation, granting priority pension benefit deemed trusts priority over security interests granted in working capital assets, nor does any federal legislation have such a provision.

On November 20, 2013, in the *CCAA* proceedings of *Aveos Fleet Performance Inc. and Aveos Technical US, Inc.*[*Aveos*],[7] the Quebec Superior Court held that pre-existing security interests granted by Aveos to its secured lenders have priority over a statutory deemed trust that had subsequently arisen under the federal *Pension Benefits Standards Act* [Federal *PBSA*][8], and found that in any event, based on an interpretation of the language of the *CCAA* and the Federal *PBSA*, the Federal *PBSA* deemed trust had no effect in a *CCAA* proceeding.

Both cases are discussed in further detail below.

Re Grant Forest Products Inc.

On March 19, 2009, certain secured creditors commenced an application for the issuance of a Bankruptcy Order against Grant Forest Products. On June 25, 2009, Grant Forest Products obtained the issuance of an Initial Order from the Ontario Superior Court under the *CCAA*. The Initial Order imposed a stay of proceedings against Grant Forest Products, including the bankruptcy proceedings that had been initiated.

The Initial Order provided that Grant Forest Products was entitled, but not required, to make pension plan contributions during the course of the proceedings.

The assets of Grant Forest Products were sold, as approved by the court, by sale approval and vesting orders granted during the *CCAA* proceedings.

After the commencement of the *CCAA* proceedings and after the sale of all significant assets by the company, the company's two defined benefit pension plans, both governed by the Ontario *PBA*, were wound up. As a result of the wind-ups, deficit obligations in the plans were triggered. As a consequence of the Ontario Court of Appeal's decision in *Indalex*, the deemed trust had been determined to have priority over other secured claims. However, at the time the appeal to the S.C.C. was still pending. In November 2012, the court in *Re Grant Forest* heard submissions on two motions: (1) a motion by Grant Forest Products for an order directing that no payments be made to the pension plans pending a release of the *Indalex* decision by the S.C.C. and (2) a motion by a secured creditor for the lifting of the stay of proceedings to permit a bankruptcy order to be made. The decision on those motions was reserved pending the S.C.C. decision.

After the S.C.C. released its decision in *Indalex*, upholding the deemed trust in respect of the wind-up deficiency, further submissions were heard by the court in *Re Grant Forest* to address the impact of that decision.

The secured creditor of Grant Forest Products argued that it was fair and reasonable for the stay to be lifted in order to permit the bankruptcy to proceed, for purposes of reversing the deemed trust priority. The pension administrator and the regulator opposed on the basis that because the liquidation of assets had been completed under the *CCAA*, there was no purpose to a bankruptcy. They argued that the secured creditor ought not to be entitled to access bankruptcy for purposes of reversing priorities, as a result of its inordinate delay in proceeding with such a request.

In rejecting the position of the parties opposing the relief, the court held that any creditor is at liberty to request that the *CCAA* proceedings be terminated if that creditor's position may be better advanced by a bankruptcy. The court found that there was no bad faith on the part of the secured creditor in seeking the lifting of the stay. It also found no prejudice to any of the stakeholders as a result of delay in pursuing the bankruptcy application, finding instead that permitting the *CCAA* process to run its course was to the advantage of all stakeholders. The court lifted the stay of proceedings to permit the bankruptcy to proceed and refused to order any payments to the pension plans.

A motion for leave to appeal this finding as well as the other holdings made in that case has been filed. No leave decision has yet been rendered as of the date of writing.

Aveos Fleet Performance Inc.

Aveos Fleet Performance Inc. ("Aveos") was a large airline maintenance company headquartered in Montreal. Given the nature of its business, it was a federally regulated company. As such, the Aveos case provided a rare opportunity to consider pension priorities in the federal context.

On March 19, 2012, Aveos made an application under the *CCAA*, and an Initial Order was made, granting, *inter alia*, a stay of proceedings against Aveos.

Aveos had financing from secured lenders to whom it had granted security over all of its assets pursuant to both a general security agreement and a hypothec, among other security documents, in March 2010.

Aveos had a defined benefit pension plan for its non-unionized employees (the "DB Pension Plan"). The DB Pension Plan was governed by the Federal *PBSA* and regulations enacted thereunder.

Part of the operations of Aveos was shut down immediately prior to the *CCAA* application, and the balance was shut the following day. With no prospect emerging for a restart of operations, Aveos's pension plans were terminated by the federal regulator, the Office of the Superintendent of Financial Institutions ("OSFI"), in May 2012.

A divestiture process of the Debtors' assets was approved by the court, and a number of sales and distributions of proceeds took place. The stay provided for under the Initial Order was extended several times during the course of the *CCAA* proceedings.

The Initial Order suspended the making of special payments to the Debtors' pension plans, including the DB Pension Plan. Upon the termination of the DB Pension Plan in May 2012, a total of $2,804,450 in special payments became due to the DB Pension Plan pursuant to the Federal *PBSA*.

OSFI brought a motion in the *CCAA* proceedings for payment of the amount due in respect of special payments triggered by the termination of the DB Pension Plan in priority to the secured lenders. OSFI based its motion on s. 8(2) of the Federal *PBSA*, which establishes a deemed trust in respect of outstanding special payments in the event of a liquidation, assignment, or bankruptcy.[9] OSFI claimed that the deemed trust created by s. 8(2) of the Federal *PBSA* obliged Aveos to pay to the DB Pension Plan the special payments in the amount of $2,804,450 in priority to the secured lenders. OSFI argued that since Aveos had sufficient cash on hand from the proceeds of its divestiture process, it was appropriate to "un-suspend" the suspension of special payments and require them to be paid.

The secured lenders to Aveos opposed OSFI's motion, on the grounds that they had security consisting of fixed charges over all of Aveos's assets, which had been perfected in 2010 and 2011, long prior to the date when liability for unpaid special payments arose, giving their security priority ranking over the deemed trust. In doing so, Aveos argued that the S.C.C.'s decision in *Royal Bank of Canada v. Sparrow Electric Corp.* [*Sparrow Electric*][10] applied to defeat OSFI's claim for payment.

In *Sparrow Electric*, the S.C.C. had considered a priority contest between a secured lender and the federal Crown in respect of income tax source deductions, which were the subject of certain statutory deemed trust language found in the federal *Income Tax Act* [*ITA*][11] as it then existed in 1997. The deemed trust provision in the Federal *PBSA* at issue in *Aveos* is substantially similar to the language considered by the S.C.C. in *Sparrow Electric*.

In *Sparrow Electric*, the S.C.C. had found that the deemed trust provisions then in effect in the *ITA* could not prevail over a prior existing fixed charge registered and perfected under the Alberta *PPSA*, as well as registered under the *Bank Act*,[12] without specific legislative language providing for such priority. Without such language, the deemed trust could only be subordinate to the fixed security of a secured creditor. The S.C.C. held that if Parliament had intended for the deemed trust to take priority, it could have done so with explicit language to that effect.

As a consequence of the *Sparrow Electric* decision, Parliament amended the provisions of the *ITA* and other similar taxing legislation to explicitly provide that the deemed trust under those statutes have priority over other security interests no matter whenever or howsoever those security interests arose.

However, the deemed trust provisions in the Federal *PBSA* were not similarly amended to overcome the effect of *Sparrow Electric*. As such, there is no language in the Federal *PBSA*, granting any priority to the deemed trust.

In ruling in favour of the secured lenders, the Quebec Court found that the reasoning of the S.C.C. in *Sparrow Electric* applied to the question of priority. The court held that the property of Aveos had already been encumbered by fixed charges in favour of the secured lenders that had been perfected long before the deemed trust arose. Since the assets were already charged, any deemed trust under s. 8(2) of the *PBSA* was subordinate to the security of the secured lenders.

In addition to applying *Sparrow Electric*, the Quebec Court also held, relying on the S.C.C.'s recent decisions in *Century Services Inc. v. Canada (Attorney General)* [*Century Services*][13] and *Indalex*, that the deemed trust under the Federal *PBSA* could not have effect in proceedings under the *CCAA*, because the deemed trust had not been explicitly preserved in the *CCAA*.

The Federal *PBSA* and the *CCAA* are both federal statutes. As such, no conflict between federal and provincial jurisdiction arises, as was the case in *Indalex*. The issue for the Quebec Court was to determine the intention of Parliament as a matter of statutory interpretation in considering the language of both statutes. The Quebec Court reviewed the provisions of the *CCAA* and found no provision preserving the deemed trust for special payments created by s. 8(2) of the Federal *PBSA* (the *CCAA* does create an express priority for unpaid normal course contributions) in the context of a sale of assets by the debtor or the approval of a plan of compromise). To the Quebec Court, the absence of protection in the *CCAA* demonstrated the intent of Parliament not to protect special payments or to provide for any priority in respect of those obligations in the *CCAA*. As a result, the Federal *PBSA* deemed trust was found to have no effect in a *CCAA* proceeding.

In coming to its decision, the Quebec Court was assisted by the S.C.C.'s conclusion in *Century Services* that where Parliament intends to protect deemed trust claims in insolvency matters, Parliament must clearly state so. The court also looked to *Indalex*, in which the S.C.C. held that Parliament had considered giving special protection to pension plan members in matters of insolvency, but chose not to.

As a result, the Federal *PBSA* deemed trust was found to have no effect in a *CCAA* proceeding.

Finally, the Quebec Court held that it was not appropriate at the late stage of the proceedings, when the divestiture process had been substantially completed and proceeds were being distributed, to amend the Initial Order in order to re-open the suspension of special payments that had been provided for in the Initial Order. The Quebec Court found that there would be prejudice to the secured lenders who had relied on such provision. Had an application been brought in a timely fashion to require special payments to be made, the secured lenders could have sought out a receivership or a bankruptcy. The Quebec Court found that a court should be extremely hesitant to modify an Initial Order retroactively after a long period of time has elapsed and after significant events in the *CCAA* process have taken place. He found the delay by OSFI in seeking to "un-suspend" special payments and to amend the Initial Order (which was only identified as a ground of relief at the commencement of the hearing, at the inquiry of the judge) was unreasonable, given that other parties had relied on the Initial Order in good faith.

There was no appeal of the *Aveos* decision.

Conclusion

While *Indalex* provided certain clarity in the ongoing battle of priorities as between secured lenders and pension plan beneficiaries, it did not resolve all questions. The body of case law has been significantly enhanced by the two cases discussed here. Since these decisions, the Quebec Court has added another wrinkle to the issue of pension priorities with its decision in the

CCAA proceedings of Timminco Ltd. and Becancour Silicon Inc., [*Timminco*]. In *Timminco*, Justice Mongeon found that the deemed trust for special payments under the Quebec pension statutes had priority over secured creditors. He found that contrary to the situation in *Aveos*, where no priority-granting language existed in the federal statute, there were provisions in the Quebec pension legislation that were capable of giving the deemed trust priority over pre-existing security interests. Leave to appeal has been sought in that case by the Monitor.

Questions continue to arise post-*Indalex*. However, as new cases are presented to the courts, additional decisions hopefully will continue to build certainty for stakeholders to inform the decisions they make when faced with an insolvency situation.

[*Editor's note*: **Katherine McEachern** is an experienced litigator who has acted for debtors, financial institutions, receivers, trustees, suppliers, and other creditors and stakeholders in all nature of insolvency and restructuring proceedings, including court-appointed and private receiverships, proposals under the *Bankruptcy and Insolvency Act*, and proceedings under the *Companies' Creditors Arrangement Act*. She acts regularly in cross-border proceedings.

Katherine thanks Sophie Tremblay, Blake, Cassels & Graydon LLP, for her assistance in writing this article.]

1 [2013] S.C.J. No. 6, 2013 SCC 6.
2 R.S.O. 1990, c. P.8.
3 R.S.O. 1990, c. P.10.
4 R.S.C. 1985, c. C-36.
5 R.S.C. 1985, c. B-3.
6 [2013] O.J. No. 4599, 2013 ONSC 5933.
7 [2013] Q.J. No. 15967, 2013 QCCS 5762.
8 R.S.C. 1985, c. 32 (2nd Supp.).
9 The Federal *PBSA* explicitly provides that the deemed trust under that Act does not apply to the wind-up deficiency, only to unpaid normal cost contributions and unpaid special payments.
10 [1997] S.C.J. No. 25, [1997] 1 SCR 411.
11 R.S.C. 1985, c. 1 (5th Supp.).
12 S.C. 1991, c. 46.
13 [2010] S.C.J. No. 60, 2010 SCC 60.

• PENSION DEEMED TRUST OUTRANKS SECURED CREDITOR IN QUEBEC DECISION •

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On January 24, 2014, Justice Mongeon of the Quebec Superior Court released his decision[1] on pension deemed trusts in the context of the insolvency of Timminco Ltd. and Bécancour Silicon Inc. (together the "Timminco Entities").

Overview

This case involves an insolvent company, a secured creditor, and two pension plans with significant deficits. The insolvent company was sold, and the secured creditor was reimbursed from the proceeds of the sale, subject to being required to reimburse any other creditors who were subsequently determined to have prior ranking. The pension plans claimed priority over the secured lender, and the Quebec Superior Court agreed, at least in part.

The competing creditors are

- The secured creditor, Investissement Québec (a government entity), pursuant to a loan it had made to Bécancour

Silicon Inc. ("BSI"). It is important to note that Investissement Québec is a secured creditor and not the Debtor-in-Possession ("DIP") lender.

- The Pension Committees, who are the administrators of the BSI Union Pension Plan and the BSI Non-Union Pension Plan in accordance with Quebec pension legislation (the "Pension Plan Administrators").

A Brief History

The *Companies' Creditors Arrangement Act*[2] restructuring of the Timminco Entities began on January 3, 2012, with an Initial Order issued by Justice Morawetz of the Ontario Superior Court of Justice (the "Ontario Court").

That order was followed on January 16, 2012, by an order suspending the special payments owed to the pension plans during the stay period.

A few months later, the Timminco Entities succeeded in selling substantially all of their assets.

Creditors were then asked to file their claims in order for the proceeds of the sale to be distributed among them. The Pension Plan Administrators each filed a proof of claim for the amounts owed to fund the solvency deficits of the pension plans as well as for the special payments that had been suspended by the Ontario Court.

Immediately thereafter, the Timminco Entities came to an agreement with Investissement Québec to repay its loan to BSI so as to avoid paying the ongoing interest payments on the loan. This Reimbursement Agreement, which was approved by the Ontario Court, provides that Investissement Québec's loan would be repaid with partial interest. However, it also requires that any creditors who are subsequently determined to have priority ranking be reimbursed by Investissement Québec. The Pension Plan Administrators therefore filed priority claims in regards to Investissement Québec and were ultimately the only creditors to do so.

Since the questions raised by the Pension Plan Administrators concerned the interpretation and application of Quebec law, the parties agreed to an Adjudication Protocol, essentially transferring the issue to the Quebec courts and setting out the process and timelines to be followed. This protocol was approved by Morawetz J. on October 18, 2012.

The Pension Plan Administrators filed a motion with the Quebec Superior Court to have their claims declared Priority Claims, which was assigned to Mongeon J.S.C. It should be noted that Mongeon J.S.C. had previously rendered a decision regarding pension deemed trusts in the *White Birch CCAA* matter.[3]

The Decision

In the *Timminco* decision, Mongeon J.S.C. reconsidered his earlier decision in *White Birch* in which he held that s. 49 of Quebec's *Supplemental Pension Plans Act* [*SPPA*][4] did not create a deemed trust. Following an analysis of arts. 1260–1262 of the *Civil Code of Québec* [*Civil Code*] and of various provisions of the *SPPA*, he concluded in *Timminco* that s. 49 of the *SPPA* does indeed create a valid deemed trust for pension contributions, including unpaid special payments.

However, Mongeon J.S.C. stated that in his view, a valid deemed trust on its own would not rank ahead of the universal movable hypothec[5] held by the creditor (Investissement Québec in this case). In addition, he stated that s. 264 *SPPA* is also required, establishing that pension contributions are non-assignable and exempt from seizure. Justice Mongeon concluded that the combined effect of ss. 49 and 264 *SPPA* is to exclude the unpaid special payments from the assets of the company. Therefore, the amount of the unpaid special payments should not have been used to repay the creditor's secured loan.

Moreover, while other Canadian provinces have, unlike Quebec, a *Personal Property Security Act* [*PPSA*] expressly providing that deemed trusts have priority over security interests, Mongeon J.S.C. was of the view that s. 264 *SPPA* has essentially the same effect.

Relying on the reasons of Justice Deschamps in *Indalex*,[6] Mongeon J.S.C. concluded that the existence of any priorities must be determined by provincial legislation and that they continue to have effect even in *CCAA* proceedings, subject only to the doctrine of paramountcy. However, in *Timminco*, there was no question of paramountcy because the secured creditor is not the DIP lender.

Finally, with respect to the actuarial deficit, Mongeon J.S.C. concluded that the deemed trust under s. 49 *SPPA* must be read restrictively and therefore cannot encompass the entire deficit.

It's Not Over

The *Timminco* case does not end here because the amounts to be reimbursed to the pension funds by Investissement Québec remain to be determined. Moreover, although neither the Pension Plan Administrators nor the secured creditor sought leave to appeal, on the last day of the appeal deadline, the Monitor (acting in the name of and on behalf of the Timminco Entities in light of super-powers granted by the Ontario Court in December 2013) filed a motion for leave to appeal Mongeon J.S.C.'s decision to the Quebec Court of Appeal.

A few weeks later, the Monitor also filed a Motion for Advice and Directions seeking permission from the Ontario Court to pursue and proceed with the motion for leave to appeal in Quebec. The Motion for Advice and Directions has now been scheduled to be heard before Morawetz J. on April 28, 2014. There will certainly be more to report in the coming weeks and months.

Impact

If Mongeon J.S.C.'s decision stands, it will represent a shift in Quebec law that will have an impact on the various stakeholders in pension plan matters.

Pension plan members and retirees appear to have gained some additional protection, while employers and lenders will likely need to pay increased attention to the funding of pension plans and ensure that pension contribution obligations are up to date.

[*Editor's note*: **Tina Hobday**, a Partner at Langlois Kronström Desjardins LLP since 2001, has developed considerable expertise in the field of pension plan governance and litigation and is currently representing pension interests in several high-profile insolvency proceedings. She has appeared before administrative boards and tribunals, as well as before all levels of courts in Quebec in civil and commercial matters.]

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1 *Timminco ltée (Arrangement relatif à)*, [2014] J.Q. no 402, 2014 QCCS 174 [*Timminco*].

2 *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

3 *White Birch Paper Holding Company (Arrangement relatif à)*, [2012] J.Q. no 3643, 2012 QCCS 1679 [*White Birch*].

4 CQLR c. R-15.1.

5 A type of security interest under the *Civil Code*, charging all property other than real estate.

6 *Sun Indalex Finance, LLC* v. *United Steelworkers*, [2013] S.C.J. No. 6, 2013 SCC 6, paras. 51 and 52.

• MUCH ADO ABOUT NOTHING: THE *AVEOS* DECISION ON DISCHARGE OF *CCAA* MONITORS •

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The Supreme Court of Canada has rendered various recent decisions that serve to highlight the broad social and economic objectives of the *Companies' Creditors Arrangement Act* as amended [*CCAA*];[1] the importance of the restructuring process and proper notice to all affected stakeholders, including especially vulnerable creditors;[2] and the broad judicial discretion of the supervising judge to be exercised with a view of promoting the policy objectives and remedial purpose of the *CCAA*.[3] These decisions also highlight the fact that often a supervising judge must consider a wide array of competing interests in the exercise of his or her judicial discretion.

On November 22, 2013,[4] Justice Mark Schrager of the Quebec Superior Court, for the judicial district of Montreal, sitting in Commercial Division, terminated the proceedings initiated on March 19, 2012, with respect to Aveos Fleet Performance Inc. and AeroTechnical US Inc. (collectively "Aveos") and rendered different orders to allow a transition from the *CCAA* to the *Bankruptcy and Insolvency Act* [*BIA*].[5] In doing so, the court dealt with different issues, including the proper scope of releases in favour of court appointed officers, which will be the subject of our comments below.

The *Aveos* decision is of significance because it offers a reasoned analysis of the proper scope of releases to be granted in favour of court-appointed officers at the end of *CCAA* proceedings. The reasons offered by Schrager J.S.C. illustrate the court's attempt to balance two potentially competing public policy objectives—namely, access to the judicial system by aggrieved parties seeking redress and the protection of court-appointed officers instrumental to the restructuring and insolvency process.

Overview of *Aveos's CCAA* Process

Almost immediately following the issuance of the Initial Order on March 19, 2012, Aveos's board resigned, which immediately prompted the Monitor to issue and file with the court a material adverse change report pursuant to s. 23(1)(d)(i) *CCAA*. Aveos, with the support of its secured lenders, presented at the same time a Motion seeking the appointment of a chief restructuring officer ("CRO"), which was granted.

As part of the *Aveos's CCAA* proceedings, the CRO and the Monitor

1. implemented a court-supervised sale process leading to various court-approved sale transactions;
2. supervised a complex process of tracing and returning a significant amount of high value customer- and supplier-owned property, including essential records required for the continued use of these assets;
3. effected, with leave of the court, various interim distributions in favour of the secured lenders;
4. obtained the proper support of the secured lenders and made, with leave of the court, various payments in favour of former employees of Aveos with respect to their priority claims and claims subject to the *Wage Earner Protection Program Act* [*WEPPA*];[6]
5. resolved certain legacy issues of Aveos with respect to certain pension claims potentially secured by way of a letter of credit originally issued by Air Canada; and
6. implemented a claim process specifically designed (1) to capture the employee claims subject to *WEPPA* while the records, resources, and personnel required for such a process were available and (2) to accelerate the mandated *WEPPA* claims process to be triggered upon bankruptcy or receivership.

Termination of *CCAA* Proceedings and Release of Court-Appointed Officers

Once substantially all of Aveos's assets had been realized and all the avenues for a potential arrangement (including a potential monetization of tax attributes) had been fully canvassed, Aveos sought leave of the court to terminate the *CCAA* and to transition the proceedings to the *BIA* by way of filing of a voluntary assignment in bankruptcy and the concurrent appointment of a receiver.

Aveos, with the support of the Monitor, was seeking the following orders with respect to the discharge of the Monitor and of the CRO (the portions underlined were denied by the court):

> [5] **DECLARE** that the Monitor and the Chief Restructuring Officer, Mr. Jonathan Solursh (together with R.el. group inc., the "**CRO**") have duly and properly discharged and performed all of their obligations, liabilities, responsibilities and duties in their capacity as Monitor and Chief Restructuring Officer, respectively, pursuant to the Initial Order, the Order issued on March 20, 2012 (the "**CRO Order**"), and all other Orders issued by this Court in these CCAA Proceedings;
>
> [8] **DECLARE** that all actions of the Monitor and the CRO from the date of their respective appointments to the time of their discharge under this Order are hereby approved, ratified and sanctioned and the Monitor and the CRO shall incur no liability under the Initial Order, the CRO Order, or otherwise, in respect of any decisions or actions taken in the context of these CCAA Proceedings, including, without limitation, with respect to any information disclosed and any act or omission, save and except for any claim or liability arising out of any gross negligence or willful misconduct.
>
> [9] **ORDER** that no action, demand, claim, complaint, or other proceedings shall be commenced or filed against the Monitor or the CRO in any way arising out of or related to their capacity, decision, actions or conduct, respectively, as Monitor and CRO, except with prior leave of this Court and on prior written notice to the Monitor and the CRO, the whole as provided by the Initial Order and the CRO Order and such further order securing, as security for costs, the full judicial and reasonable extrajudicial costs of the Monitor and the CRO in connection with any proposed action or proceedings as the Court hearing such motion for leave to proceed may deem just and appropriate.[7]

The analysis of Schrager J.S.C. ultimately rests on a reasoned attempt to balance competing policy interests. He was of the view that the fact that given the broad discretion afforded to a *CCAA* judge, the decision to grant discharges to the Monitor and the CRO in a termination motion was within the discretion of the judge. He was of this view notwithstanding the fact that the *CCAA* already provides for certain specific statutory releases and does not contain a specific provision providing a general release at the termination of a monitor's duties.[8] Justice Schrager concluded as follows concerning the court's jurisdiction to grant releases and discharges:

> 25 However, given the broad discretion afforded a CCAA judge, the decision to grant discharges to the Monitor and the CRO in a termination motion is within the discretion of the judge. In the opinion of the undersigned, the exercise of this discretion is governed by policy and the circumstances of each case [reference omitted].[9]

In denying the latter part of conclusion number 8 (reproduced above), Schrager J.S.C. nevertheless underlines the following:

1. points out that he did, in the context of specific orders, grant, in the course of the *CCAA* restructuring, specific broad releases in favour of the Monitor and the CRO in relation to matters specifically referred to in said orders
2. points out that the CRO was already protected in the order dated March 20, 2012, appointing it, and that such protection was justified, given that a CRO, unlike a monitor, does not enjoy any specific statutory protections as those afforded to a monitor with regard to employee and environmental issues and the risk that he be characterized as a *de facto* director and be made subject to personal statutory liabilities, given the specific facts of this case, including the resignation of the board of directors and the uncertainty at that time of the ability of Aveos to renew its existing D&O policy insurance[10]
3. approved, ratified, and sanctioned all the actions of the Monitor and of the CRO from the date of respective appointments to the time of their discharge, with a view of bringing finality and certainty to the restructuring process with respect to all matters specifically brought before the court: in doing so and even if though it is not specifically mentioned in his reasons, Schrager J.S.C. was certainly mindful of the extensive and detailed reporting done through the *CCAA* proceedings both by the Monitor who had issued 26 reports and by the CRO who had also issued 15 reports and of the notices that had been issued and published throughout these proceedings
4. granted the latter part of conclusion 9 (which contemplated the posting of security for costs), which was appropriate, given the special status of the Monitor as an officer of the court and worthy of special protection,[11] even though it did not bind in any way a judge who could eventually hear a motion seeking leave to institute proceedings against a former monitor
5. specifically made favourable comments concerning the manner in which the Monitor and the CRO had performed their duties and functions:

> 35 Nothing herein should be interpreted as any indication that this Court is aware of any fact,

> circumstance or action of the Monitor (or the CRO) in this file that might engender their liability. To the contrary, both the Monitor (and its representatives) and the CRO (and his team), exhibited throughout not only a high degree of professional conduct but also business acumen and practical initiative so as to bring about relatively positive solutions in very unfortunate circumstances not of their making.[12]

Comments

We are of the view that while any court-appointed officer would certainly favour a full and final release of all liability in respect of their activities at the conclusion of a file, the *Aveos* decision affords an appropriate level of protection in favour of monitors upon their discharge inasmuch as the court's decision is based on timely and proper reporting and the monitors' actions are duly approved, ratified, and sanctioned by the court. While it recognizes that monitors are entitled to special protection as officers of the court, the *Aveos* decision refuses to grant a blanket immunity from liability "… arising in factual circumstances in the course of the administration not put before the Court regarding parties not necessarily before the Court".[13]

In fashioning its discharge orders along the lines suggested by Schrager J.S.C. in the *Aveos* decision, courts would, in our view, encourage an even more transparent process based on extensive and timely reporting to all potentially affected stakeholders. Given the specific findings made by Schrager J.S.C. and the reasons of his Order, the *Aveos* decision should not be considered as a potentially dangerous precedent for court-appointed officers, but rather as a careful attempt to balance important competing policy objectives in line with recent rulings of the Supreme Court. As Justice Abella stated for the majority in *TCT Logistics*:

> 45 These statutory parameters, though sufficiently flexible to authorize a wide range of conduct dealing with the taking, management, and eventual disposition of the debtor's property, are not open-ended. The powers given to the bankruptcy court under s. 47(2) are powers to direct the interim receiver's conduct. That section does not, explicitly or implicitly, confer authority on the bankruptcy court to make unilateral declarations about the rights of third parties affected by other statutory schemes.
>
> 50 Trustees, receivers and the specialized courts by which they are supervised, are entitled to a measure of deference consistent with their undisputed expertise in the effective management of a bankruptcy. Flexibility is required to cure the problems in any particular bankruptcy. But guarding that flexibility with boiler plate immunizations that inoculate against the assertion of rights is beyond the therapeutic reach of the *Bankruptcy and Insolvency Act*.[14]

Given the traditional role, duties, and functions of a monitor,[15] which can be contrasted with those imposed on a trustee in bankruptcy who is vested with the rights and property of a bankrupt in accordance and subject to s. 67 *BIA*, the potential for liability of a monitor appears to be very limited within the *CCAA* framework. While the *Aveos* decision may suggest that there remains a limited exposure to potential proceedings against a monitor after a proper discharge has been granted, past experience would indicate that this risk may well be only hypothetical. It would be helpful if future decisions dealing with this issue emphasized the need for stakeholders to raise any concerns with the actions of a monitor in a timely fashion and that the courts should not entertain potential litigation against a discharged monitor once the court-supervised process has run its course, save in exceptional circumstances where such threatened litigation could not have been raised prior to discharge. At that point, discharged monitors (assuming the *CCAA* process was conducted properly, based on extensive and timely reporting to all potentially affected stakeholders) and discharged trustees may well be facing the same level of residual risks, which from a policy perspective would seem fair and appropriate.[16]

[*Editor's note*: **Sylvain Rigaud** acted as counsel to FTI Consulting Canada Inc. and Toni Vanderlaan acted as the Senior Managing Director in charge of the Aveos matter on behalf of the Monitor.]

1 *CCAA*, R.S.C., 1985, c. C-36; *Century Services Inc. v. Canada (Attorney General)*, [2010] S.C.J. No. 60, 2010 SCC 60, paras. 15, 17, and 18) [*Century Services*].

2 *Sun Indalex Finance, LLC v. United Steel Workers*, [2013] S.C.J. No. 6, 2013 SCC 6 at paras 72–75, 81–83, 217, and 276 [*Indalex*]; *GMAC v. T.C.T. Logistics*, [2006] S.C.J. No. 36, 2006 SCC 35 [*TCT Logistics*].

3 *Century Services*, *supra* note 1, paras. 57–59 and 64–70.

4 The reasons for the judgment rendered on November 22, 2013, were subsequently issued on November 28, 2013. See [2013] Q.J. No. 13899, 2013 QCCS 5924, No. 500-11-042345-120 [*Aveos*].

5 R.S.C., 1985, c. B-3.

6 S.C. 2005, c. 47, s. 1.

7 *Aveos*, *supra* note 4, para. 20.

8 Unlike s. 41(8) *BIA* providing that upon discharge by the court, a trustee in bankruptcy is discharged from all liability in respect of any act done or default made by him in the administration of the estate or in relation to his conduct as trustee, subject to possible revocation by the court on proof that said discharge was obtained by a fraud or by suppression or concealment of a material fact.

9 *Aveos*, *supra* note 4, para. 25.

10 Paragraph 11 of the March 20, 2012, Order appointing the CRO provided that

> [11] ORDERS that the CRO shall incur no liability or obligation as a result of his engagement or the fulfillment of his duties in the carrying out of the provisions of his engagement or as may be ordered by this Court, save and except for gross negligence or willful misconduct on his part, and no action or other proceedings shall be commenced against the CRO as a result of or relating in any way to his engagement as CRO, the fulfillment of his duties as CRO or the carrying out of any of the orders of this Court, except with prior leave of this Court.

11 In doing so, Schrager J.S.C. decided not to follow the reasons expressed by Justice Clément Gascon, j.s.c. (as it then was) in *Mecachrome international inc.*, [2010] J.Q. no 6017, 2010 QCCS 2683.

12 *Aveos*, *supra* note 4, para. 35.

13 *Ibid*., para. 32.

14 *TCT Logistics*, *supra* note 2, paras. 45 and 50.

15 *CCAA*, *supra* note 1, s. 23.

16 As per s. 41(8) *BIA*, *supra* note 5.