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Submissions

- Brief to the Department of Finance
  Dec 5, 2002
- **CAIRP/IIC Paper on Insolvency Law Reform**
  Mar 15, 2002
- Streamlining Consumer Bankruptcy
  Mar 15, 2001
- OSB Funding Paper
  Jan 10, 2000
- OSB Funding Options
  Feb 16, 1999
- Student Loans
  Jun 8, 1998
- Draft Directives
  Dec 12, 1997

March 15, 2002

Business Insolvency Law Reform

BILR Task Force Report: 1 - March 2002
Author: Task Force of the IIC and CAIRP
Description:
Final report from the Joint Task Force on Business Insolvency Law Reform from the Insolvency Institute of Canada (IIC) and the Canadian Association of Insolvency & Restructuring Professionals (CAIRP)
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BILR Task Force Report: CAIRP
Author: Task Force of the IIC and CAIRP
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BILR Task Force Report: IIC
Author: Task Force of the IIC and CAIRP
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The Insolvency Institute of Canada
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BILR Task Force Report: Letter to Industry Canada
Author: Task Force of the IIC and CAIRP

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BILR Task Force Report: Schedule A
Author: Task Force of the IIC and CAIRP
Description:
Reform Proposals

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BILR Task Force Report: Schedule B
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Reform Proposals with Commentary
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SCHEDULE B

REFORM PROPOSALS

WITH COMMENTARY

A. INTERIM FINANCING

DEBTOR IN POSSESSION ("**D.I.P.**") LENDING

Usually during CCAA proceedings, one key to a successful restructuring is enabling the debtor company to carry on some or all of its operations while it is negotiating with creditors for a plan of arrangement or compromise. The debtor may be able to fund its ongoing operations from its cashflow if it is not required during the CCAA proceedings to make any payments to pre-filing creditors and if the enforcement of any security interests over the debtorís working capital assets is stayed. However, the debtor may need access to additional funds to finance, for example, seasonal fluctuations in inventory, mandatory capital expenditures, the professional and other costs of the restructuring proceedings or, in extreme cases, negative operating cash flows. In those situations, the debtor may require interim debt financing, commonly referred to as debtor in possession financing, in order to continue operating.

While the CCAA is silent on the question of interim financing, Canadian courts have decided that they have the inherent and equitable jurisdiction to authorize D.I.P. financing for necessary expenditures during the stay period. This exercise of discretion has been endorsed at the appellate court level. D.I.P. financing allows the debtor company to operate on a short term basis while all parties assess whether there is a plan of arrangement or compromise that can be negotiated that is acceptable to the general body of creditors. However, there continues to be debate regarding the scope of the court's jurisdiction to order D.I.P. financing and the basis upon which that jurisdiction should be exercised. Thus it would be helpful to expressly codify the court's authority in the CCAA and to give the court guidance in its consideration as to whether to grant such financing and on what basis.

The reform proposals that follow support the necessity of such financing. An underlying policy principle of these recommendations is that a basic goal of the system is to facilitate going concern solutions where possible and where greater value is to be realized from a viable restructuring rather than a liquidation. Interim financing is aimed at facilitating a going concern solution that maximizes the value that will ultimately be realized for creditors, and minimizes the economic and social costs of insolvency. The proposals suggest that there should be codification of principles that the court should consider in determining whether to approve interim financing. The proposals are thus both facilitative in terms of codifying the court's current authority, and substantive in the guidance that they would offer the court in the exercise of its authority to approve D.I.P. financing.

The proposals encompass both fairness and efficiency considerations. The fairness objective is advanced where D.I.P. financing facilitates the continuation of the debtor company as a going concern pending negotiations for a workout, thus preserving jobs for a period, preserving enterprise value, and ultimately preserving or enhancing value for creditors. Fairness also includes giving pre-existing creditors notice of requests for financing and an opportunity to make submissions to the court. The recommendations are efficiency enhancing as they will encourage good governance during the workout period, allow greater certainty in interim financing decisions, and reduce the transaction costs associated with litigation over D.I.P. financing by clarifying the factors that the court will consider in the exercise of its jurisdiction and by simplifying the legal steps that are needed in order to implement D.I.P. financing.

The D.I.P. financing proposals do not apply to BIA proposal proceedings. There is a concern that D.I.P. financing should be relatively exceptional, since it is an expensive device, may result in the wasteful continuation of restructuring proceedings that are doomed to fail, and can be used abusively. There is a view that D.I.P. financing should not be introduced into smaller cases where the relevant considerations, particularly relating to governance of the debtor, are in practical terms much harder to manage. However, there is also a contrary view that the D.I.P. financing option should be available in BIA proposal cases in order to maximize the possibility of successful reorganizations and that the concerns about costs, delay and abuse are exaggerated.

Provide in CCAA cases for an express statutory power to authorize borrowing ("D.I.P. loans") and grant security in specified amounts for post-filing advances and supplies of goods and services necessary to fund the debtor during

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the restructuring proceedings, such power to be authorized according to criteria to be specified in the statute.

This proposal codifies the courtsí current exercise of jurisdiction, authorizes D.I.P. financing and allows for the granting of security in specified amounts for post-filing advances and necessary goods and services. Such a provision would clarify the courtsí authority to grant security on post-filing cash advances to fund the debtor during the CCAA proceedings. The provision would also permit the continuation of the practice in some Western CCAA cases of obtaining D.I.P. financing from trade creditors through the supply of goods and services post-filing on credit as an alternative to a financier providing cash advances. There have been some controversies arising from the use of trade credit in CCAA financings so the trade credit alternative would have to be implemented with particular care. The language of all other D.I.P. related proposals are drafted just to reflect D.I.P. financing in the form of an outright loan from a lender, but are meant to be applied to both forms of D.I.P. financing.

The reason for the "post-filing" restriction is that at the point of filing under the CCAA, the debtor is under the court-supervised process and the proceeding includes a court-appointed monitor that can assess the necessity and scope of such financing or the granting of security for goods and services. This supervisory role can prevent unnecessary prejudice to the interests of creditors while affording the debtor access to necessary goods and services to continue operating. D.I.P. financing will also allow the debtor to engage the required professional advisers to assist in devising a restructuring plan and allow the debtor to finance the costs of the proceeding.

"Specified amounts" creates certainty in the amount being approved by the court and allows creditors a basis on which to assess the request for financing based on the potential value to be realized with a viable plan. It will facilitate co-operation between debtors and creditors, allowing each to assess the best option in respect of their interests. The proposal also recommends that the court exercise its discretion to grant D.I.P. financing according to criteria specified in the statute. Those criteria are contained in the following proposal.

Provide that in deciding whether or not to authorize a D.I.P. loan, the court should consider amongst other things, the following factors:

what arrangements have been made for the governance of the debtor during the proceedings;

whether management is trustworthy and competent, and has the confidence of significant creditors;

how long will it take to determine whether there is a going concern solution, either through a reorganization or a sale, that creates more value than a liquidation;

whether the D.I.P. loan will enhance the prospects for a going concern solution or rehabilitation;

the nature and value of the assets of the debtor;

whether any creditors will be materially prejudiced during that period as a result of the continued operations of the debtor; and

whether the debtor has provided a detailed cash flow for at least the next 120 days.

This proposal emphasises the link between the granting of interim financing and the governance of the corporation during the workout period. The factors are aimed at giving substantive guidance to the court in determining whether there are adequate governance mechanisms in place if further credit is to be granted, but are not intended to be binding rules so that the court will retain flexibility. The purpose behind the granting of D.I.P. financing is to allow the debtor a period to determine whether there is a viable plan of arrangement or compromise that can be devised and that is acceptable to creditors as specified by the statute. The factors suggested here align with the objectives of the legislation, which is to encourage a going concern solution to the debtor's financial distress where possible.

D.I.P. financing may involve some prejudice to creditors, but it also potentially enhances value for creditors. Creditors are generally willing to compromise their claims or to suspend enforcement of their claims for a limited period and amount if they are satisfied that there is a reasonable prospect of a viable restructuring plan. The criteria listed in this recommendation are aimed at facilitating this consideration. They are not mandatory nor are they exhaustive. Rather, they will provide guidance to the court as well as to all interested parties, in the kinds of factors that will be important to the granting of D.I.P. financing requests. They balance greater certainty in D.I.P. financing applications with the need to maintain a degree of flexibility in fashioning a workout process that meets the needs of multiple stakeholders. Key to the granting of such financing is that the process is court-supervised and that the monitor is available to report on the financial and business affairs of the debtor.

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In terms of the specific factors listed in this recommendation, governance is important because creditors want some assurance that the business is being operated and the CCAA proceedings are being conducted in a manner that does not unnecessarily prejudice their interests during the period the debtor is under CCAA protection. Confidence by creditors and the court that the managers are competent and trustworthy is key to this assessment of governance. The assessment of the expected time frame is also an important consideration. While there should not be rigid statutory limits on the time frame for which the financing is granted (although the D.I.P. lender may set time limits on the availability of the D.I.P. financing), the court and creditors generally need some assurance that the debtor will act expeditiously to determine whether there is a going concern solution, whether that is best realized through a restructuring or sale as a going concern, and whether the proposed solution generates more value for creditors than a liquidation. The court will assess whether the debtor is acting in a timely manner to devise the proposed plan and present it to creditors in the context of the expected time frame.

The proposal also recommends that the court should assess whether the D.I.P. financing will enhance the prospects for rehabilitation of the debtor. This is aimed at ensuring that the financing is linked to the objectives of the legislation, specifically, to facilitate a going concern solution where viable and where it will enhance return to diverse stakeholders. The court should also give consideration to the nature and value of the assets of the debtor, considering for example, whether there is remaining equity in the debtor corporation or whether there are assets that are capable of supporting the implementation of a viable plan. The court would also be required to consider whether any creditors will be materially prejudiced during the period for which D.I.P. financing is granted. Given that the purpose of D.I.P. financing is to allow the corporation to "keep the lights on" during the vitally important stay period, the court must balance multiple interests in determining the amount and scope of D.I.P. financing. This includes assessment of material prejudice likely to be suffered by a creditor or creditors as a result of the continued operation of the debtor. Finally, the recommendation suggests that the court should assess whether the debtor has provided a detailed cash flow for at least the following 120 days. Such an assessment would afford the court a clearer picture of what the D.I.P. financing is required for and how the debtor views its ability to carry on business during the workout period.

The proposal does not address the relative weight to be placed on the various factors. In practice, factors (b) (confidence in management) and (f) (material prejudice to creditors) are likely to be important in all cases.

The suggested criteria meet both the fairness and efficiency objectives of the CCAA. The decision to grant financing will enhance fairness by being more transparent and accountable to diverse stakeholders. With respect to enhanced efficiency, the criteria will allow the court to consider the governance of the debtor, to reduce where possible the social and economic costs of immediate firm failure, to balance prejudice in the granting of D.I.P. financing, and to prevent delay and cost where possible.

Provide automatic statutory protection for D.I.P. lenders and debtors against tort damages and other claims for entering into court authorized D.I.P. loans in breach of pre-filing covenants and other obligations.

This protection facilitates the ability of the debtor to obtain D.I.P. financing without potential financiers and the debtor having to risk defending claims of breach of covenants and other obligations in respect to pre-existing restrictive covenants. The statutory protection would be automatic, once the court authorizes the D.I.P. financing based on consideration of the above-recommended factors. It would enhance the efficiency objectives of the legislation by codifying protection to D.I.P. lenders and the debtor after the exercise of the court's jurisdiction.

Provide that the court order itself can create the D.I.P. lien on the property of the debtor described therein without the need for security documents.

Provide that the D.I.P. lien need not be registered in order to be effective against pre-filing creditors or a trustee in bankruptcy, but notice of the order must be registered under the provincial personal property security laws applicable in the locality of the debtor, and against title to real estate in order to have priority over subsequent purchasers (with protection for purchasers acting in the ordinary course of business) and secured lenders acting for value and without notice of the court order.

These two proposals would facilitate financing under CCAA proceedings and address the issue of liens on property of the debtor. Proposal #4 allows the court to create a D.I.P. lien without the cost of having to generate separate security documents, a power that would be particularly helpful to address matters of urgency.

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Complementing this facilitative power, proposal #5 addresses protection of post-filing creditors. Proposal #5 specifies that the D.I.P. lien does not need to be registered in order to be effective against pre-filing creditors or a trustee in bankruptcy, because such creditors will receive notice of the D.I.P. lien and thus have the information to assess whether or not to advance further credit to the debtor where D.I.P. financing is in place. However, in order to be effective against post-filing secured creditors or subsequent purchasers, notice of the court order creating the lien would be required to be registered under the applicable personal property security regime of the locality of the debtor and against the title for real estate. This would give subsequent lenders and purchasers notice of the existence of the lien, thus facilitating future financing because subsequent lenders and purchasers would have a publicly available mechanism to check on prior secured interests. All creditors would have some form of notice that the D.I.P. lien exists, and would be able to make their credit decisions on an informed and less costly basis. In this respect, the recommendations enhance both fairness and efficiency.

Provide that the court has jurisdiction to provide that the D.I.P. lien has priority ("prime") over all or such other existing security interests as may be specified by the court (except source deduction deemed trusts).

Provide that the court shall not prime a registered or possessory security interest without at least 48 business hours notice to the affected secured creditor.

These recommendations address the power of the court to grant new security that has priority over pre-existing security. Canadian courts have held that they have authority to grant priority over pre-existing secured creditors in respect of D.I.P. financing applications under the CCAA. Proposal #6 codifies and clarifies the current jurisdiction and practice of the court. It specifies that the priority would not apply to source deduction deemed trusts. However, such priming should not occur without the debtor giving at least 48 business hours notice to affected secured creditors. In this respect, the practice has been somewhat uneven, and in the past, courts have granted such priority without notice to affected secured creditors. Although creditors can currently come before the court and object under the "come-back" provisions of such orders, it can be difficult to persuade the court that the primed D.I.P. financing should be set aside or approved in a lessor amount or with particular conditions that ensure effective governance during the period covered by the D.I.P. financing. An assessment of the need for D.I.P. financing and the scope of its priority over pre-existing secured credit should be undertaken with as many interests represented before the court as possible.

Generally, a debtor should know at least 48 hours prior to an application that it requires the D.I.P. financing on a priority basis in order to secure such financing. Fairness requires notice, so that affected secured creditors can assess the request for financing and the implications for their security. This recommendation does not prevent the granting of D.I.P. financing without notice, but does require that it will not be granted on a priority basis without 48 business hours notice (e.g. before 10:00 a.m. on Thursday for a hearing at 10:00 a.m. on Monday; before 10:00 a.m. on Monday for a hearing at 10:00 a.m. on Wednesday assuming that Monday and Tuesday are not holidays). The 48-hour period would allow creditors sufficient time to assess the debtor's immediate financial needs, the risk to their own security, and to formulate a position as to whether the request for D.I.P. financing meets the above-recommended statutory criteria. It would give the secured creditors an opportunity to determine whether they wish to argue to the court that granting the financing would materially prejudice their interests. The recommendation would ensure a more transparent and informed decision by the court, without unduly delaying the granting of such relief to the debtor company. It would also encourage communication and negotiation between the debtor and secured lenders before the commencement of proceedings before the court.

It is not intended that the court should "prime" security interests previously granted by the court in the same CCAA proceedings without the consent of the affected parties.

Provide that in deciding whether to exercise the power to prime other security interests, the court should be required to use the existing balancing of prejudices/limited prejudice test developed by the courts when exercising inherent jurisdiction.

This proposal codifies the current manner in which the court exercises its discretion in terms of balancing the interests of creditors, the debtor, employees and other stakeholders in considering whether to prime existing secured claims when authorizing D.I.P. financing requests. The court engages in a balancing of prejudices, which in turn meets both fairness and efficiency goals of the legislation by considering multiple interests. The considerations concerning whether to prime existing security interests are in addition to the list of criteria set out in proposal #2 which apply to all D.I.P. financings. The specific formulation of the additional test for priming liens will have to be drafted with some care in order to accurately reflect the existing case law.

The U.S. model of "adequate protection" was rejected because it is costly and time consuming to evaluate collateral; it is highly litigious and costly to determine whether there is adequate protection, and the U.S. model lacks flexibility. Instead, proposal #8 endorses retention of the existing balance of prejudice/limited prejudice test.

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Provide that at the time a priming D.I.P. lien is authorized, the court be given the statutory power to authorize and create liens to protect the primed secured creditors to the extent that they are prejudiced by reason that upon enforcement the proceeds of the collateral of such secured creditors are used to repay the D.I.P. loan (with the same rules concerning registration, priority, appeals etc. applying to such liens as apply to D.I.P. liens).

This proposal is facilitative in nature. For example, the D.I.P. lender may get a charge over all assets, which may prime an existing secured creditor with security over operating assets. The D.I.P. lender is likely in practice to look to the current assets first to recover payment of the D.I.P. loan if the restructuring process fails. There may be value in the fixed assets that could be available for the existing secured creditor to recapture the value of its claim if a plan is not approved or fails. The court would be given power to authorize and create liens to protect the primed secured creditors to the extent that their security could be prejudiced by the primary D.I.P. lien.

Provide that in the event that a priming D.I.P. lien is enforced, the court has the authority to allocate on a just and equitable basis how the burden of the D.I.P. lien is ultimately to be borne by the primed secured creditors.

Currently, there is no mechanism to apportion the burden of D.I.P. financing with priority over secured creditors having claims against different classes of assets. Yet the rationale for granting the financing is that it is in the interests of creditors generally to grant financing for a limited period to see if a viable plan is possible. Since the benefits accrue to a broad number of stakeholders, it seems appropriate that the court be granted the discretion to apportion the costs as well. A "just and equitable" standard would allow the court to balance the prejudice as well as the potential benefits accruing to a going concern solution.

Provide that with respect to advances authorized by a court order and made prior to receipt by the D.I.P. lender of written notice of any subsequent order (whether made by way of appeal or otherwise) varying, staying or rescinding the authorizing order, that the rights of D.I.P. lender under the authorizing order with respect to such advances shall not be affected by such subsequent order.

This proposal is facilitative and addresses the concern by a D.I.P. lender that an order for financing will be varied on appeal and that money already advanced pursuant to that order risks losing its priority. The statute would be amended to specify that where advances have been authorized by the court and already made, a subsequent court order varying, staying or rescinding the D.I.P. financing order will not affect the priority of advances made prior to written notice of the variance, stay or recission. This will create greater certainty for D.I.P. lenders, enhance the ability of the debtor to secure D.I.P. financing, and thus advance the rehabilitation objectives of the legislation.

OTHER INTERIM FINANCING ISSUES

Provide (in both CCAA and BIA proposal cases) that unsecured claims for goods and services (including real property and true personal property leases) provided (in the ordinary course of business and consistent with the statutes and any court orders) post-filing have priority over pre-filing unsecured claims.

This proposal is aimed at protecting the expectations of trade suppliers and other creditors who continue to supply goods and services after the debtor company has filed under the provisions of the CCAA or proposal provisions of the BIA. Given that the objective of the restructuring provisions is to find a going concern solution where possible, it is essential that the debtor continue to receive goods and services during the stay and negotiation period in order to keep operating, maintain employment, and preserve customers and other goodwill. While in many ways it is preferable that post-filing goods and services be paid for on a C.O.D. basis, that is not always practical. This recommendation would provide some protection for post-filing suppliersí claims by giving those claims priority over pre-filing unsecured claims, where the goods and services, including real property and true personal property leases, are provided in the ordinary course of business. The provision of such goods and services and any resultant claims would have to be consistent with both statutory requirements and the terms of any court order for the post-filing supplier to have priority over pre-filing unsecured creditors. The priority would not extend to give priority over secured creditors, so it would not give much protection in cases where the debtorís assets are fully encumbered.

Provide (in both the CCAA and BIA proposal cases) that after filing, the debtor should not obtain additional credit from any person, including a supplier or a lender, without first giving the person appropriate notice of the proceeding.

Proposal #13 addresses an existing problem that creditors, particularly suppliers, may not be aware of the CCAA or BIA proposal proceedings and continue to grant credit to the debtor post-filing. It would require the debtor to give appropriate notice of the proceeding to any person from whom it

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was seeking or receiving credit, including suppliers and lenders. What is "appropriate" notice would have to be determined on a case-by-case basis, and the legislation would have to give the court flexibility to recognize the practical difficulties of giving notice, particularly in larger cases. For example, reasonably timely public advertising might well be sufficient in many cases. The supplier or lender could then make a more informed determination as to whether or not to lend or provide supplies based on an assessment of the risks involved in the granting of such credit. This proposal addresses both fairness and efficiency considerations.

Fairness requires the debtor not to take advantage of smaller or less informed creditors; it allows those creditors access to information that senior secured creditors and the debtor already have concerning the existence of the CCAA or BIA proceeding. The recommendation is also efficiency enhancing because notice allows for more informed risk assessment prior to advancing new supplies or credit. It would allow the creditor to make arrangements for payment of the goods and services, where possible, out of the D.I.P. financing. Such creditors should not bear a disproportionate amount of risk because they were not advised that the debtor company was under insolvency proceedings. The proposed notice protection for creditors should also contribute in the long-term to enhancing the availability of credit during restructuring proceedings.

Provide that the court shall not permit a CCAA or BIA proposal case to continue if it is not satisfied that adequate arrangements have been made for payment for post-filing goods and services.

This provision is aimed at ensuring that the CCAA and BIA proceedings are brought in line with one another. Underlying this proposal are many of the same considerations as the previous recommendation. Suppliers of goods and services are often creditors who have fewer resources, less bargaining power, and greater information barriers in terms of participating in restructuring proceedings. If the debtor is to continue under a stay, the court should be satisfied that adequate arrangements have been made for payment of post-filing goods and services. Again, practicality requires that this threshold should be applied in a reasonable manner. The court should not be required to receive strict proof of absolute assurance of payment, but rather that the debtor is not proceeding recklessly without reasonable regard for the position of post-filing suppliers. This proposal will enhance fairness by reducing the risk that suppliers of post-filing goods and supplies are unduly prejudiced by the conduct of the proceedings. It will also enhance efficiency in creating greater certainty in the debtor obtaining the goods and services required to continue operations during the brief but vitally important workout period.

Provide (in both CCAA and BIA proposal cases) that no payments are to be made or security granted with respect to pre-filing unsecured claims without prior court approval (obtained after the initial order), except that with the prior written consent of the monitor/trustee (unless otherwise ordered by the court) the following pre-filing claims can be paid:

source deductions;

wages (including accrued vacation pay), benefits and sales tax remittances not yet due or not more than seven (7) days overdue at the date of filing; and

reasonable professional fees (subject to subsequent assessment) incurred with respect to the filing.

Provide (in both CCAA and BIA proposal cases) that no payments are to be made or additional security granted with respect to pre-filing secured claims (including security leases) that are subject to the stay without the prior approval of the court.

Provide that during a reorganization proceeding if there is no readily available alternative source of reasonably equivalent supply, then in order to prevent hostage payments the court has jurisdiction, on notice to the affected persons, to order any existing critical suppliers of goods and services (even though not under pre-filing contractual obligation to provide goods or services) to supply the debtor during the reorganization proceeding on normal pricing terms so long as effective arrangements are made to assure payment for post-filing supplies.

These three proposals complement one another and balance a prohibition on payment of pre-filing claims with important carve outs to recognize particular needs and interests. Proposal #15 prohibits payments being made or security granted to pre-filing unsecured claims without prior court approval. This prohibits the debtor from giving a preference to unsecured creditors, to the prejudice of more senior creditors or other unsecured creditors. However, the recommendation also recognizes that there are circumstances where it is in the interests of the debtor company as well as the general body of creditors to make payments. These include source deductions such as income tax, employment insurance and pension deductions, wages, accrued vacation pay, benefits and sales tax remittances that are not yet due or not more than 7 days

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overdue when the debtor files its application. In such cases, the debtor corporation, with the prior written consent of the monitor or trustee, can pay the claims without the cost and delay of having to obtain a court order.

This meets fairness objectives in that employees are being paid specified amounts and will be encouraged to stay through the restructuring. Tax remittances held in trust can also be paid for a limited period. The monitor or trustee acts as a check on behalf of the court and the general body of creditors in approving the payments. The debtor can go to the court if it believes that the monitor or trustee is withholding consent without valid reason.

The debtor would also be permitted to pay reasonable professional fees incurred with respect to the filing, also with the prior written consent of the monitor or trustee and subject to subsequent assessment by the court. This will facilitate timely filing of CCAA applications and commencement of the restructuring negotiations, and should prevent excessive appearances before the court. The subsequent assessment condition provides creditors with an avenue to object to these payments if they believe that they are excessive or unreasonable.

Proposal #16 is a prohibition on payments to be made or additional security to be granted to pre-filing secured creditors. This is aimed at ensuring both that a preference is not given to one or more secured creditors and that such creditors are not in a position to extract hostage payments from the debtor company during the stay period. Thus it is aimed at protection of the general body of creditors. Payments can be made or additional security granted if the court gives prior approval. Thus the general prohibition is tempered by granting the court discretion in its supervisory capacity to approve payments or security where appropriate.

Proposal #17 then recognizes that there may be instances in which there is no readily available alternate source of supply that is reasonably equivalent to the goods or services of a particular supplier. In order to prevent that creditor from extracting hostage payments during the restructuring proceeding, i.e. from demanding credit on excessive terms because the debtor has no ability to contract with another supplier, the recommendation puts in place a mechanism for the court to supervise the issue of continued supply of goods and services. The court would have the jurisdiction, on notice to the affected persons, to order an existing critical supplier of goods and services, even where it was not under a pre-filing contractual obligation to continue supplying, to supply the debtor company during the reorganization proceeding. The court would have authority to order this on normal pricing terms, as long as effective arrangements were made to ensure payment for post-filing supplies. Thus the creditor would be required to continue to supply for a fixed period on normal pricing terms, but it would not be required to accept normal payment terms and the arrangement for payment by the debtor would have to satisfy the court that it was effective and timely. If the supplier had legitimate reasons for refusing to supply or for requesting increased pricing (for example, in order to recover extraordinary costs), the court would have authority to protect the supplier.

These three proposals together allow the debtor some discretion in respect of allowing payments, under supervision of the court-appointed officer, while ensuring that the general body of creditors is protected from the debtor preferring pre-existing creditors or being held hostage by a critical supplier. The fairness objectives are that it allows the debtor to continue to receive needed supplies and services, while balancing the interests and prejudice to other creditors. In terms of efficiency objectives, there is likely to be need for fewer court appearances if all stakeholders, including court-appointed officers and creditors, are given clear guidelines on the scope and ability to make payments or grant additional security during the stay period.

B. GOING CONCERN AND ASSET SALES

During a restructuring process, the debtor company may need to sell parts of its business in order to generate capital for the restructuring or to prevent further depletion of value from the financially unhealthy parts of the operation. These are sales outside of the ordinary course of business. Such a sale may enhance the debtor's prospects for survival of the healthy part of the business, by allowing it to focus its efforts on the turnaround of those operations. There is a tension in allowing the debtor to do this in specified circumstances, while protecting creditors from further unnecessary diminution of the value of their claims.

In addition, the best way to restructure and save a business may be to allow a new owner to purchase all or substantially all of assets used in that business on a going concern basis. Such a sale can achieve the basic policy objectives of maximizing the recovery to creditors while minimizing the economic and social costs of the insolvency. There is no general policy reason to favour "reorganization" of the debtor as a legal entity over such a sale.

The concerns addressed by the following proposals involve the protection of the interests of creditors during the CCAA proceeding, while granting the debtor limited flexibility in its governance during the stay period by allowing for court-approved asset sales. The proposals allow for a harmonization of practices under receiverships and under the CCAA. Asset sales can provide improved realizable value for the debtor and ultimately creditors, at the same time as enhancing prospects for saving the debtorís business on a going concern basis. Codification of when and how such sales should occur would give direction to the parties and the courts in their consideration of these issues. The following proposals clarify the scope of the court's authority and set out factors that the court should consider in determining whether to approve a sale process.

Once again, these proposals apply to CCAA proceedings and not BIA proposal proceedings. For reasons similar to those given above with respect to the issue of D.I.P. financing, there is a division of views and no consensus on whether it is advantageous to give the debtor the same sale powers in a BIA proposal proceeding as in a CCAA proceeding.

Provide that in CCAA cases the debtor may with the prior approval of the court sell part of its assets and/or business out of the ordinary course of business in order to downsize and/or raise capital for a restructuring plan.

Provide that in CCAA cases the debtor may with the prior approval of the court sell all or substantially all of its assets and business on a going concern basis.

These proposals generally codify and clarify the court's current exercise of jurisdiction. The debtor may, with the prior approval of the court, sell part of its assets or the business out of the ordinary course of business, prior to a meeting of creditors to approve a plan of arrangement or compromise. Proposal #18 specifies that the debtor company may seek approval of the court to sell part of its assets and/or business in order to effect a downsize and/or to raise capital for a restructuring plan. It recognizes that such a sale may be the debtor's best chance for survival of the healthier parts of the business, and that such a sale may be optimal in maximizing value for creditors because those assets have a higher realizable value sold.

Proposal #19 is aimed at more substantial sale applications, making a distinction in terms of when the court will approve such sales. The debtor could seek court approval to sell all or substantially all of its assets and business, however, this would be allowed only on a going concern basis. The proposal would allow going concern sales in appropriate cases, where the court was satisfied that this was in generally in the interests of creditors. It would not, however, allow the sale to be used as a liquidation proceeding. The recommendations thus distinguish situations in which the sale looks more like a liquidation, which is more appropriately undertaken under the statutory provisions designed to realize on the assets through liquidation.

These recommendations facilitate asset sales where there are social and economic benefits to be realized. There may be enhanced efficiency in allowing the debtor to withdraw from unhealthy operations or to conduct an asset sale outside of the ordinary course of business in order to facilitate a restructuring or a going concern solution. While the debtor should have some flexibility to fashion a structure that will allow the business to survive where viable, fairness suggests that this should only occur through the route of asset sale and prior to a creditors' meeting where the court is satisfied in respect of the sale process. However, the debtor would not be able to seek an order to sell on a liquidation basis all or substantially all the assets except in the very limited circumstances set out in proposal #25 below. The guidelines outlined in the next recommendation would give substantive direction to the court in terms of factors to consider in its determination of whether or not to approve a partial sale or a sale of substantially all the assets on a going concern basis.

Provide that in deciding whether or not to exercise its authority to approve a material sale in the course of a CCAA proceeding, amongst other considerations, the court shall have regard to whether the sales process has been conducted:

in a fair and reasonable manner;

by an insolvency administrator;

by a credible, independent chief restructuring officer reporting to a credible, independent restructuring committee of the board of directors either with or without supervision of the court; and/or

in consultation with major creditors.

This proposal outlines factors that the court should consider in determining whether to exercise its authority to approve a material sale during the course of a CCAA proceeding. These factors are not meant to be required conditions nor are they meant to be an exhaustive list. Rather, they require the court to have regard to how the sale process has been conducted or is proposed to be conducted. The assessment of "fairness and reasonableness" in the sale process would allow the court the same kind of fairness inquiry that it currently engages in when the court assesses a proposed plan of arrangement or compromise. Given that such a sale is being conducted prior to a meeting of creditors, unsecured creditors will not have been part of the process and the fairness inquiry allows the court to balance the benefits and prejudice involved in the sale. Furthermore, if affected secured creditors have not consented to the sale, it is important for the court to be vigilant to prevent abuse and self-dealing.

Consideration of who conducts the sale and how the sale is conducted are also key factors. It is assumed that in all cases the debtor has involved

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competent, ethical and credible professional advisors (financial and legal) appropriately in the process. The court must be satisfied that the sale will maximize the value of assets, be conducted in a manner that will minimize prejudice to creditors, and maximize prospects for a fair and cost effective going concern solution where possible. In the case of the insolvency administrator (which means a licensed trustee acting as an interim receiver, a monitor or similar official) both statutory duties and professional codes of conduct govern the professional. Thus use of an insolvency administrator will signal to the court that the sale process has been designed and conducted having regard to the general interests of creditors.

The recommendation also suggests that a chief restructuring officer (CRO) could conduct a sales process if that party is considered credible and independent and is accountable to a restructuring committee of the board of directors that is also credible and independent. In this way, the court can assess whether the sale enhances both the rehabilitative prospects of the debtor corporation and is in the interests of the general body of creditors and other stakeholders. The sales process could be conducted either with or without the supervision of the court, although the sale would still be subject to court approval. This allows "pre-packaged" plans, where the debtor has structured and carried out a sale process in a manner that allows it to maintain customer and supplier goodwill or protect going concern value. The court must still approve the sale.

This proposal provides flexibility in the sale process. Where necessary, the court can supervise the terms and progress of the sales process. However, where there are skilled and credible professionals, with experience and ability to maximize value on an asset sale, they should be allowed to develop and carry out a sale process, subject to court approval of the sale. Finally, the recommendation suggests that a factor that the court should consider is whether the sales process has been conducted in consultation with major creditors. Such creditors are in a position to evaluate the benefits and disadvantages of a material sale outside of the ordinary course of business. Their support may signal to the court that the sale process has been designed and carried out to create the highest realization of the value of the assets or that financially inefficient operations are sold in a manner that limits their negative effects on remaining assets.

Provide that absent exceptional circumstances, the court shall not approve a sale if controlling shareholders, directors, officers or senior management of the debtor have a significant financial interest in the purchaser or in the sales transaction, unless there was a proper sales process either subject to court supervision or conducted by persons acting independently of such persons.

This recommendation addresses what are often called "quick-flips", where major shareholders, directors or other senior officers are involved in a material sale of assets out of the ordinary course of business and have a significant financial interest in the purchaser or in the sales transaction. The recommendation permits such sales only where the sales process was subject to court supervision or conducted by persons acting independently of the shareholders or officers. It guards against self dealing transactions by directors, officers and controlling shareholders in terms of transferring value away from creditors to these equity holders.

The recommendation recognizes that in some cases, the sale of assets to these parties does maximize value for creditors, because the controlling shareholder or officer is the only party with the capital and the willingness to take a particular asset. In such cases, the requirement that the sale process was conducted either under court supervision or through a process that is independent, permits such sales but without permitting self dealing transactions. It should ensure that the greatest value possible is realized within the CCAA proceeding.

Provide that the court has the power to vest assets (and to make any ancillary orders necessary to give effect thereto) wherever located, that are subject to a court approved sale, in the purchaser free of any interest of the debtor or of persons (including the debtor's secured creditors) claiming through the debtor, with the proceeds of such sale being automatically subject to the same secured claims in the same priorities as the assets were immediately before the time of vesting.

Provide that provincial bulk sales legislation does not apply to sales approved by the court.

These two proposals are facilitative in nature, allowing the smooth transfer of assets where the sale process has been approved by the court. The court currently exercises this jurisdiction, but codifying this authority should reduce transaction costs by creating greater certainty in respect of the scope of the court's jurisdiction. Proposal #22 expressly provides the court with the power to vest assets in the purchaser where the assets are subject to a court-approved sale. This vesting in the purchaser can occur wherever the assets are located. The assets are vested free of any interest of the debtor or creditors. This allows sales for value and allows the purchaser to acquire title or ownership of the assets free of any claims. The proceeds from the sale would then be automatically subject to the same secured claims that the assets were subject to, and in the same priority. This protects creditors' claims to the value of the assets, subjecting them to the same security and thus

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the same protection in the hierarchy of claims. The recommendation will assist in all jurisdictions, but particularly will assist with asset sales in Quebec, where there is not a concept of the court transferring title to a third party by way of a vesting order.

Proposal #23 codifies the current process undertaken by some courts under sale processes within CCAA proceedings. The recommendation is thus facilitative. Given that the court must approve the sale process having regard to the same kinds of considerations as apply in a bulk sales inquiry, the recommendation could eliminate unnecessary duplication and transaction costs. The proposal is thus aimed at simplifying and streamlining the sale process, while still protecting the interests of creditors in ensuring that a material asset sale or bulk sale outside of the ordinary course of business maximizes the value of assets.

Provide that in connection with a sale approved by the court, the debtor and the applicable insolvency administrators may provide the purchaser with information subject to privacy laws restrictions, provided that the purchaser agrees to comply with the policies, if any, of the debtor with respect to privacy and with applicable privacy laws.

This proposal is aimed at aligning the sale process with new privacy legislation. It will facilitate asset sales by allowing potential purchasers access to information that may be a valuable asset of the debtor company, in order to assess the value or potential value of the assets. The purchaser would be required to comply with the existing privacy policies of the debtor, as well as applicable privacy laws. Thus the recommendation balances the need for information in order for a potential purchaser to realistically assess the value of information based assets, while maximizing protection of that information for the individuals who may be part of customer lists or other information subject to privacy legislation.

Provide that if the debtor is to cease carrying on business and all or substantially all of its remaining assets are to be realized upon or sold other than on a going concern basis, that unless otherwise agreed by the unsecured creditors of the debtor pursuant to a plan of arrangement or proposal, the debtor is to be placed into bankruptcy or receivership.

While codifying the ability to conduct assets sales and the factors to be considered by the court will facilitate restructuring plans, it is equally important to ensure that a sales process is not a means to avoid a proper bankruptcy or liquidation procedure. This recommendation is an anti-abuse provision designed to deal with liquidations that occur without court approval. If a debtor is to cease carrying on business and assets are to be sold or realized on other than on a going concern basis, the debtor should be required to proceed through receivership or bankruptcy unless otherwise agreed by the creditors. It would prevent the debtor from conducting a pure liquidation under the protection of a CCAA restructuring proceeding. Liquidation should be conducted through the legislative scheme that provides a governance structure and a mechanism for realization and distribution of proceeds, being in commercial matters the BIA. This would ensure consistency in liquidation, prevent debtors from forum shopping in terms of how they proceed with liquidation, and ensure that the liquidation occurs under the supervision of licensed professionals who are best able to realize and distribute the value of the assets.

The single exception would be where the unsecured creditors have otherwise agreed under a CCAA plan of arrangement or a BIA proposal. The exception allows a carve out on the prohibition on liquidation in order to create flexibility, where unsecured creditors have agreed and the court is satisfied that the plan or proposal meets the statutory requirements.

C. EXECUTORY CONTRACTS

What is an executory contract? Neither the CCAA nor the BIA use the expression, but the United States Bankruptcy Code does in s.365 ("Code, s.365"). In general contract law, "executory contract" means a contract under which one or both parties still have obligations to perform. However, in U.S. bankruptcy law the expression is normally given a narrower meaning. According to the most widely accepted definition in the United States, an executory contract for the purposes of Code s.365 is:

"a contract under which both the obligations of the bankrupt ["A"] under the contract and the other party to the contract ["B"] are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other".

(Countryman, "Executory Contracts in Bankruptcy" (1974) 57 Minnesota Law Review 439 (Part 1), at 460 (emphasis added)).

The following are some examples of contracts that are executory contracts in this sense:

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an uncompleted construction contract under which the customer agrees to pay the builder as the work progresses;

a distribution agreement or other contract for the supply of goods or services from time to time for which the supplier periodically bills the customer;

a real estate lease or a true lease of personal property under which the lessee pays periodic rentals;

a technology licensing agreement under which the licensor agrees to provide maintenance and updating facilities and the licensee pays royalties from time to time; and

an employment contract.

The issue that executory contracts in the bankruptcy sense raise is this: how does Aís bankruptcy affect Aís and Bís respective rights and obligations under the contract. Or, more particularly:

can Aís trustee assume the contract (i.e., can the trustee keep the contract going even though B wants to terminate it)?

can Aís trustee reject the contract (i.e., can the trustee terminate the contract even though B wants to keep it going)?

can Aís trustee assign the contract to a third party contrary to a provision in the agreement and without Bís consent and with or without variation?

Aís trustee may want to take one or other of measures (a)-(c) in order to maximize the value of the estate for the general benefit of Aís creditors. A parallel set of questions arises in the case where A makes a BIA or CCAA reorganization proposal. In the reorganization context, A may want to take one or other of measures (a)-(c) to facilitate a successful reorganization outcome.

Currently, Canadian provincial laws outside Quebec provide a relatively comprehensive set of rules relating to real estate leases in a bankruptcy of the tenant. There are no corresponding provisions for the case where the bankrupt is the landlord. In the case of reorganization proposals, different rules apply to real estate leases. More significantly, perhaps, there are no corresponding provisions for other kinds of executory contracts (true leases of personal property, licence agreements, and so on).

By contrast in the United States, Code, s.365 contains a comprehensive set of rules governing executory contracts and leases. It is not limited to particular kinds of contracts, though it does contain special rules for certain cases. Nor is it limited to formal bankruptcies (Chapter 7 proceedings). It applies to all kinds of bankruptcy proceedings including Chapter 11 proceedings (reorganizations).

Should Canada adopt a s.365-type provision? The main arguments in favour are as follows:

Increasingly, maintenance of valuable contractual rights (e.g. licenses of intellectual property, etc.) is absolutely essential for the survival of businesses as going concerns.

The rules governing executory contracts in bankruptcies and reorganizations vary : (1) depending on the kind of contract in issue and in particular on whether or not the contract is a real estate lease; and (2) between Quebec and the common law provinces. They also vary, sometimes needlessly, between bankruptcies and reorganizations and between BIA and CCAA reorganizations. The re-enactment of the rules in a single provision would facilitate rationalisation and make the rules easier to understand.

So long as the counter-party (party B) is no worse off than it would be in a pure liquidation, there is no prejudice to the counter-party in adopting rules analogous to the U.S. provisions.

Outside the context of real estate leases, the law is incomplete and uncertain. For example, while BIA, s.65.1 provides for the assumption of contracts in a BIA reorganization, there is no corresponding provision to cover the case where a trustee in bankruptcy is attempting to carry on Aís business in order to sell the enterprise as a going concern.

Provide that in CCAA proceedings, BIA proposals and BIA liquidation proceedings, the debtor (with the prior written consent of the monitor/trustee) or the trustee in bankruptcy should have the power to disclaim executory contracts (including real property leases) existing as of the date of commencement of proceedings subject to the following limitations:

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the right of disclaimer should not apply to eligible financial contracts, or to other financing agreements including security leases where the debtor is the borrower or lessee;

where the debtor is the lessor of real or personal property, or the licensor of intellectual property, the disclaimer should not affect the rights of the counter-party to maintain possession and use of the leased or licensed property, subject to the counter-party continuing to perform its obligations under the applicable lease or licence except to the extent that its payment obligations thereunder would have been released (but for the disclaimer) by it setting off valid claims for damages for the debtorís failure to perform its obligations after the date of a disclaimer; and

to the extent that any payments made pre-filing pursuant to an executory contract for the purchase of property created a lien or ownership rights in certain assets of the debtor according to the law applicable to the assets, upon disclaimer of the executory contract the purchaser should have a lien on those assets subject to any security interests or other claims having priority over such pre-filing lien or ownership rights.

Provide that if such disclaimer rights are exercised in the course of a CCAA or BIA proposal case, the counter-party should have a provable pre-filing unsecured claim in the proceedings for any termination damages (determined according to existing formula in the case of real property leases) but no set-off rights with respect thereto.

Provide that in a reorganization proceeding, the counter-party to an executory contract should have the right to set off pre-filing claims against pre-filing obligations, but not against post-filing obligations.

There should be a general right to disclaim (reject) executory contracts (including real property leases) in all bankruptcy and reorganization proceedings. There would be no need for court approval. By and large, this proposal simply tracks existing CCAA practice. The legislation could impose some pre-conditions to the exercise of the disclaimer power either generally, or with respect to certain types of contracts.

The right of disclaimer should not apply to eligible financial contracts or to other financing agreements, including security leases of personal property where the debtor is the borrower or lessee. In this connection, there should be a provision in the BIA and CCAA that expressly recognizes the distinction between security leases and true leases of personal property, with security leases being treated as secured financings. Where A (the insolvent party) is the lessor of real or personal property, or the licensor of intellectual property, the disclaimer should not affect Bís rights to maintain possession and use of the leased or licensed property, subject to Bís continued performance of its obligations. To the extent that any payments B made pre-filing pursuant to an executory contract for the purchase of property created lien or ownership rights in Aís assets, upon disclaimer of the executory contract B would have a lien on the assets subject to any prior-ranking security interests or other claims. The object of this measure is to protect property entitlements that vest in B before the contract is disclaimed.

There should be a provision to say that if disclaimer rights are exercised in the course of BIA or CCAA reorganization proceedings, B should have a provable pre-filing unsecured claim in the proceedings for any termination damages (determined according to the existing formula in the case of real property leases: see BIA, s.65.2(4)), but no rights of set off in relation to the claim. It should be clear that insolvency administrators (trustees in bankruptcy, receivers, etc.) have no personal liability to perform the debtorís obligations under executory contracts.

Provide that in connection with a court approved going concern sale of all or any part of the debtorís business, the purchaser may receive an assignment of any executory operating contracts (for greater certainty, not including eligible financial contracts) applicable to such business.

Provide that trustees in bankruptcy and court-appointed receivers should have the power to assign executory contracts (not including eligible financial contracts) both in connection with going concern transactions and on a liquidation basis.

Provide that the foregoing rights to assign should not be limited by any prohibition on assignment contained in the executory contract, but should not be applicable to any executory contract which under the general law applicable to the contract is not by its nature assignable.

Provide that the court may prohibit the assignment of an executory contract if the counter-party establishes that either:

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the proposed assignee does not meet, in a material way, lawful criteria reasonably applied by the counter-party before entering into similar agreements (e.g. franchise agreements); or

the proposed assignee is less credit worthy than the debtor was when the executory contract was entered into, and reasonable assurances of payment have not been provided with respect to any credit required to be extended to the assignee by the counter-party under the executory contract after the assignment.

Provide that in the event of a CCAA filing, an executory contract (other than an eligible financial contract or financing agreement) should not be subject to termination by reason of the proceedings or the insolvency of the debtor.

Provide that in the event of a CCAA or BIA proposal case, any provision in an executory contract (other than an eligible financial contract) that by reason of the proceeding or the insolvency of the debtor changes the provisions of the executory contract in a manner that is materially adverse to the debtorís interests is void.

The right of A or Aís trustee to assume an executory contract is tied to Bís right to terminate it. In relation to Bís right of termination there should be a provision in the CCAA to say that in the event of a CCAA filing, an executory contract (other than an eligible financial contract or financing agreement) is not subject to termination by reason of the proceedings or the insolvency of the debtor. The aim is to bring the CCAA into line with the BIA: compare BIA, s. 65.1. The reason for BIA, s.65.1 is that Bís termination of the contract might prejudice Aís reorganization proposal. However, B may have other rights under the contract that are potentially prejudicial to Aís reorganization proposal: for example, a right to unilaterally modify the contract, or a right of pre-emption. To cover these cases, the CCAA and BIA should stipulate that, in the case of CCAA or BIA proceedings, any provision in an executory contract (other than an eligible financial contract) which provides that by reason of the proceeding or Aís insolvency the provisions of the contract are changed in a manner that is materially adverse to Aís interests is void. Likewise, the statutes should stipulate that, in the event of CCAA or BIA proceedings, any provision in an executory contract that entitles B by reason of the proceedings or Aís insolvency to purchase property of Bís for a total consideration that is less than current fair market value is void.

Executory contracts (other than eligible financial contracts) should be assignable in reorganization proceedings as part of a court approved going concern sale of the debtorís business. They should also be assignable by a trustee in bankruptcy or a court- appointed receiver, both in connection with going concern sales and on a liquidation basis. The right to assign should not be limited by any prohibition on assignment contained in the executory contract, but it should not apply to any executory contract which under the general law applicable to the contract is not by its nature assignable (compare U.S. Code, s.365(c)(1)(A)). There should be provision for the court to prohibit an assignment if B establishes that the proposed assignee does not meet, in a material way, criteria reasonably applied by B before entering into similar agreements (as in the case of franchise agreements) or the proposed assignee is less creditworthy than A was when the executory contract was entered into and reasonable assurances of payment have not been provided with respect to any credit required to be extended to the assignee by B under the executory contract after the assignment.

The scheme for assignments outlined above is similar to the rules for assignments that currently govern landlord and tenant agreements in the tenantís bankruptcy. One principal difference is that, in the landlord and tenant context, the trusteeís right of assignment depends in all cases on court approval. Under our proposal, court proceedings would be necessary only if B chose to challenge the assignment. U.S. Code, s.365 is also to be contrasted in this respect.

One key issue remains unresolved because of differences of views among insolvency practitioners. If the debtor owes money under an executory contract, should that claim be treated simply as an unsecured claim, or should it be a condition that if the contract is retained by the debtor or assigned that those arrears be paid? Current provincial laws that provide for the assignment of real property leases by trustees in bankruptcy of the tenant require that any arrears of rent be paid on closing of the assignment. On the other hand, imposing this requirement generally with respect to executory contracts arguably prefers one class of unsecured creditors over the general body of unsecured creditors and improves the contracting partyís position as compared to a straight liquidation. If the various proposals concerning executory contracts are adopted, this issue will have to be resolved as part of the amendments.

Provide that in the event of any insolvency proceeding with respect to a debtor, any provision in an executory contract (other than an eligible financial contract) that entitles the counter-party by reason of the proceedings or the insolvency of the debtor to purchase property of the debtor for a total consideration that is less than current fair market value is void.

Provide that in connection with the approval of a plan of arrangement or proposal or of a sale in the course of a CCAA proceeding, the court has summary jurisdiction to declare an executory contract to be in full force and effect so long as there is no material uncured default other than the failure to pay pre-filing monetary claims.

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The legislation should provide that, in connection with the approval of a plan of arrangement or a proposal or a sale in the course of a CCAA proceeding, the court has summary jurisdiction to declare an executory contract to be in full force and effect so long as there is no material uncured default other than the failure to pay pre-filing monetary claims. This measure is a mechanism to avoid uncertainty about the status of an executory contract in reorganization proceedings which may be necessary in order to be able to obtain the financing necessary in order to complete the reorganization.

Provide for express statutory recognition in the CCAA and BIA of the distinction between security leases and true leases of personal property, with security leases being treated as secured financings.

At the moment the case law under the BIA and the CCAA is contradictory as to whether a security lease of personal property is to be treated as a security interest or a lease. Provincial personal property security laws treat a security lease as a security interest, and it is recommended that the confusion with respect to insolvency law be resolved by adopting the same principle.

D. GOVERNANCE

One of the basic thrusts of the reform proposals is to confer greater powers on the debtor in order to facilitate the survival of businesses as going concerns either through reorganizations or sales. This puts a greater premium on ensuring that the persons controlling the process on behalf of the debtor are acting in good faith and competently, and have a reasonable degree of support from key creditors. Accordingly, a number of reform proposals have been developed to encourage the debtor and other parties to properly address governance issues at the outset of reorganization proceedings, and to create additional legal tools to address any difficulties with respect to the governance of the debtor.

Provide statutory authority during CCAA and BIA proposal cases for the court to appoint an interim receiver and manager (being a licensed trustee in bankruptcy) in order to protect the debtorís estate or the claims of creditors, with such authority as the court may determine including the authority to manage the reorganization proceedings.

Provide that during the course of a CCAA or BIA proposal case, the court has the authority to replace some or all of the existing directors of the debtor if the governance structure of the debtor is impairing or could impair the process of developing and implementing a going concern solution.

Experience has shown that there can be an advantage in having the debtorís management retain control of its operations during reorganization proceedings. However, there are certain situations, such as those in which management has lost the faith of creditors, where the court should have the ability to alter the debtorís management, including by replacing some or all of the existing directors or by appointing a qualified party with some degree of authority to manage the debtorís operations.

The BIA already provides for the appointment of an interim receiver or a trustee during the course of reorganization proceedings. In proceedings under the CCAA the court is required to appoint a monitor to "monitor the business and financial affairs of the company." However, the prevailing view is that this mandate does not include taking control of the operations of the debtor. Proposal #38 gives the court the power to appoint an interim manager, or an interim receiver and manager, to permit the court to replace management while allowing the reorganization process to continue. This prevents unscrupulous managers from holding the reorganization process "hostage" for their own benefit. Moreover, neither statute makes any provision for replacement of a debtorís directors (although such provisions may be contained in the debtorís enabling legislation or the terms of a private arrangement such as a pledge of shares in favour of a lender). Proposal #39 gives the court additional powers to address governance issues without jeopardizing the restructuring process.

Provide that the directors and officers, and applicable insolvency administrators, have a duty to notify the court on a timely basis if they have actual knowledge that there is a material risk that the debtor will be unable to pay wages or other debts being incurred during the course of a restructuring proceeding.

Provide that in exercising their duties during the course of a reorganization proceeding, the debtorís directors and officers and the applicable insolvency administrators shall take into account the priority of the claims of creditors and equity holders, and the apparent value of those claims in light of the likely range of values of the business and assets of the debtor.

Managing the affairs of an insolvent debtor often involves balancing the conflicting interests of parties with claims of different value and priority in the face of considerable uncertainty about the values of the business and assets of the debtor. However, proposal #14 makes it clear that this balance should not involve significant prejudice to suppliers of post-filing goods and services. Proposal #40 complements proposal #14 by providing that officers, directors and applicable insolvency administrators have a duty to inform the court once a material risk of such prejudice becomes apparent.

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It is difficult to specify in the abstract how the interests of other claimants should be balanced, and we have not attempted to do so here. Proposal #41 would provide statutory recognition of the inherent complexity of these situations. This would reinforce the trend in Canadian jurisprudence toward recognizing that, in insolvency, the fiduciary duties of officers and directors include an obligation to consider the best interests of creditors as well as shareholders. How those competing interests are to be balanced will depend upon the facts of each case.

Provide that an interim receiver or a receiver within the meaning of section 243 of the BIA (excluding mortgagees in possession and other secured creditors directly enforcing their security) and a CCAA monitor must be a licensed trustee in bankruptcy.

Provide that a monitor must, prior to its appointment, make written disclosure to the court of its business and legal relationships with the debtor.

The different types of receiver have a variety of roles, but usually receivers are responsible for managing the business of the debtor and/or disposing of its assets. The importance of receivers and their duties to a variety of interested parties (not just the party which sought the receiverís appointment) has been recognized over the years by the growing number of federal and provincial statutes that impose express statutory duties on receivers. It is therefore important for the integrity of the system that receivers be persons of demonstrated competence who are subject to regulatory and licensing requirements.

Although a monitor appointed under the CCAA does not manage the affairs of a debtor company, he or she does play a critical role in collecting and transmitting information about the debtorís affairs to the court and the debtorís various stakeholders. Consequently, it is important to ensure that a monitor is a person of demonstrated competence whose ability to act impartially is not compromised by conflicts of interest. The standards proposed above are already imposed upon trustees who play an analogous role in the context of proceedings under the BIA. It is anomalous to hold monitors under the CCAA to less stringent standards than their counterparts under the BIA, especially in light of the fact that matters dealt with under the CCAA are typically more complex than those disposed of under the BIA. Furthermore, with respect to preferences it is proposed below that a monitor be given the same powers as a trustee in bankruptcy to challenge reviewable transactions.

There is considerable debate within the industry as to whether or not the existing statutory authority permitting the auditor to the debtor to act as monitor should be replaced with a prohibition. This debate is complicated by a debate over what role the monitor should play. In many cases, the monitor also acts as financial advisor to the debtor, and this tends to make the CCAA process cheaper and faster. On the other hand there is clearly a tension between acting as both the debtorís advisor and as a watch dog for the court and the creditors. There is general agreement that at a minimum a proposed monitor should make full disclosure of its relationships with the debtor before being appointed, and that is the basis for proposal #43. Further consideration is being given to this issue to see if a general consensus can be developed to support additional proposals in this area.

Provide that during the course of a CCAA or BIA proposal case, the court has the authority to grant a court-ordered charge in favour of interim receivers and managers, monitors, trustees and other insolvency administrators up to a fixed amount to secure their reasonable fees and expenses, subject to assessment, and, up to another fixed amount to indemnify them against third party liability to the extent that insurance is not available on reasonable terms for such liability, with exclusions for wilful misconduct and gross negligence.

Provide that the same rules concerning registration, priority, appeals, etc. shall apply to charges in favour of insolvency administrators as apply to D.I.P. liens.

Insolvency administrators play crucial roles in the governance of an insolvent debtor. Attracting and retaining qualified insolvency administrators is impossible unless they can be assured of recovering reasonable fees and expenses. In straight bankruptcy proceedings this objective can be achieved (if the debtorís assets are not fully encumbered) by treating the fees and expenses of the trustee and legal costs as preferred claims. The above recommendations would permit, but not require, the court to accomplish essentially the same purpose in the context of reorganization proceedings.

These recommendations would also give the court the ability to secure insolvency administratorsí access to indemnification against third party liability, subject to exclusions for wilful misconduct and gross negligence. As discussed below, insurance or indemnification against third party liability is an important and standard part of the overall compensation package for senior managers of both solvent and insolvent debtors. Insurance and indemnification form an equally important component of the compensation package offered to insolvency administrators. This is because so long as the debtor continues to exist as an operating entity there is a meaningful risk that those involved in its governance will incur liability to third parties. Insolvency professionals reasonably insist upon being compensated for bearing that risk. Once indemnification against third party liability (subject to the specified exclusions) is understood as a form of compensation, it becomes clear that the court should have the ability to grant a charge to secure such an indemnity for the same reasons that it should have the ability to grant a charge to secure fees and expenses. Additionally, the court should have authority to authorize insolvency administrators to obtain insurance at the expense of the estate when insurance is readily available at reasonable rates. Creditors would generally prefer reasonably priced insurance to a secured indemnity.

The potential for abuse of these charges will be limited by the facts that a) it is recommended that the court have discretion over whether to grant them, and b) insolvency administrators are accountable for their actions to the court and their fees

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and expenses are subject to assessment.

Provide that service of the initial CCAA order or of notice of the commencement of a BIA proposal case on an insurer that provides unexpired directorsí and officersí insurance, shall be deemed to be notice within the policy period of all claims that are subsequently made against the directors and officers relating to the failure of the debtor to pay pre-filing claims or the insolvency of the debtor.

Liability insurance for officers and directors is normally written on a ëclaims madeí basis and for relatively short periods of time. Identifying and providing notice of all possible claims on a timely basis is particularly difficult in the case of an insolvent debtor because of the number of potential claims. This recommendation would provide officers and directors of an insolvent debtor with additional time in which to identify and provide notice of claims. This would limit the extent to which they are distracted from the task of managing the affairs of the debtor during the course of a reorganization. Before this proposal is implemented there should be consultation with the insurance industry to ensure that the industry has a fair opportunity to make any premium adjustments that may be necessary to reflect any perceived change in the insurance risk.

Provide that during the course of CCAA or BIA proposal cases, the court has the authority to grant a court-ordered lien up to a fixed amount in favour of the debtorís directors and officers to indemnify them against third party liability for post-filing conduct to the extent that insurance is not available on reasonable terms for such liability, with exclusions for wilful misconduct and gross negligence.

Provide that the same rules concerning registration, priority, appeals, etc. shall apply to charges in favour of directors and officers as apply to D.I.P. liens.

Provide that when deciding whether or not to grant a charge in favour of the directors and officers, particularly in CCAA cases, the court shall consider whether the debtorís board has established appropriate governance mechanisms, whether by establishing an independent board committee, retaining a CRO or other means, for the proper management of the debtorís affairs during the course of the restructuring proceedings.

Provide that during the course of a restructuring proceeding the debtor shall not pay, or enter into an agreement to pay, retention bonuses, success fees, severance or termination pay or other extraordinary remuneration to its senior management, officers and directors without prior court approval, but that if so approved, the court shall have the discretion to provide that payment of all or part of those amounts are secured by a directorsí and officersí charge.

Outside of insolvency, the officers and directors of a debtor are typically provided with insurance and indemnification from the solvent corporation against third party liability, subject to exclusions for wilful misconduct and gross negligence. It is reasonable for an officer or director to demand similar protection before remaining or becoming involved with an insolvent debtor. However, once the debtor becomes insolvent the value of its indemnity is greatly reduced. In these circumstances the relevant personnel should be required to resort, in the first instance, to insurance markets. However, insurance against third party liability may not be available on reasonable terms or the scope and effectiveness of the coverage may be too limited. In those circumstances officers and directors should be entitled to apply to the court for a charge to secure their indemnity. This will give debtors experiencing financial distress an opportunity to retain and/or attract skilled personnel. The potential for abuse by incompetent or untrustworthy individuals will be limited by the facts that a) it is recommended that the court have discretion over whether to grant this charge and in fact, pursuant to proposal #49, be expressly directed to take into account the quality of a debtorís governance structure when exercising that discretion and, b) pursuant to various other proposals the court will have significant ability to intervene in the management of the debtor after the charge has been granted.

Provide that the debtorís independent directors have protection from any personal statutory liability otherwise arising from the debtorís failure to pay pre-filing debts (e.g. wages, vacation pay, GST, etc.) so long as the debt is not more than seven (7) days overdue at the time of the commencement of a CCAA or BIA proposal case.

Provide that directors and officers shall have no personal liability for severance and termination pay claims arising during the course of a reorganization proceeding.

Provide that insolvency administrators shall have no personal liability for vacation, severance and termination pay claims arising upon the commencement of, or during the course of, insolvency proceedings, and that insolvency administrators shall have no personal liability for unfunded pension plan liabilities.

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A variety of federal and provincial statutory provisions impose personal liability upon directors and officers for certain obligations owed by the debtor, in many cases without any requirement that the officer or director in question be at fault. These provisions generally seek to encourage officers and directors to exercise their control over the debtor to ensure that amounts due are paid to certain involuntary or vulnerable creditors. However, the premise upon which these provisions are based is of questionable validity in the case of bona fides insolvency. The ability of officers, directors and insolvency administrators of an insolvent debtor to control payments made to vulnerable creditors is limited by the fact that other parties, such as the court and various creditors or stakeholders, also exercise significant control over the debtorís affairs, and may in fact be able to induce an unplanned cessation of operations. For this reason it is neither fair nor fruitful to impose no-fault personal liability upon officers, directors or insolvency administrators for post-filing obligations owed to vulnerable creditors. Consequently, we recommend that the statutory provisions that impose the most economically significant no-fault obligations ñ those dealing with termination and severance pay ñ be suspended while the debtor is subject to reorganization proceedings. In effect, this would replace the unrealistically stringent obligation imposed by a no-fault regime with the more reasonable obligation set out in proposal #40, i.e., the obligation to notify the court when there is a material risk that obligations owed to post-filing suppliers of goods and services ñ regardless of their degree of vulnerability ñ will not be satisfied.

Similar logic supports the recommendation to relieve independent directors of personal liability for obligations arising immediately prior to a filing. Independent directors typically have little or no control over whether such obligations are satisfied and so it is not appropriate to hold them personally liable for these sums so long as the debtor files for reorganization or bankruptcy on a timely basis before there are significant arrears.

Finally, it is also important to provide clear protection from personal liability with respect to legacy employee liabilities for receivers and managers, interim receivers, trustees in bankruptcy and other similar officials. The current uncertainty in the law in this area creates a powerful disincentive for insolvency administrators to operate a business on an interim going concern basis while exploring whether there is the possibility of finding a going concern solution. This uncertainty perversely increases the risk of permanent loss of employment by discouraging going concern solutions and encouraging pure liquidations.

Provide that the court has the statutory authority to establish claims bar processes with respect to court created indemnity charges to facilitate the timely reduction of those charges during the course of the proceeding and their timely release at the end of the proceeding.

Proposal #54 would give the court explicit statutory authority to implement an important method of providing finality in reorganization proceedings. Otherwise distributions to creditors could be delayed for many years as a result of the various court-ordered liens contemplated by the proposals.

E. PLAN APPROVALS

Provide expressly for the court to have the authority to establish claims bar dates for voting and/or distribution purposes under the CCAA, and for appropriate summary proceedings to resolve disputes.

Provide that the proof of claim date for CCAA plans shall be the date of the initial order.

Provide that in a CCAA proceeding, the debtor is required to obtain court approval of the classification of creditors proposed in its plan of arrangement before the plan is circulated to the creditors for voting purposes.

Unlike the BIA, the CCAA provides virtually no guidance on the procedures that are to be followed in securing approval of a plan of reorganization. These proposals codify existing best practices and resolve certain jurisdictional issues.

Provide that the "head count" test provided for with respect to creditor class approval for a reorganization be eliminated to reflect the development of vulture capital markets, and provide for the repeal of Section 110 of the BIA.

The term "head count test" refers to the rule applicable to both BIA and CCAA reorganizations that creditors representing a majority in number - as opposed simply to two-thirds in value - of a class must vote in favour of a proposal or plan in order for acceptance by that class to occur. There is generally no corresponding requirement under applicable corporate law when reorganizing solvent entities.

The development of ëvultureí capital markets, i.e. markets for claims against companies experiencing financial distress, has created considerable difficulty in the application of the "head count" test. Claims tend to be sub-divided into small amounts, and it becomes increasingly difficult to establish the identity of the legal owners of the claims. In addition, in some cases vulture investors have deliberately sub-divided claims in an effort to gain a veto over the restructuring process.

The principal practical effect of the head-count rule is to increase the bargaining power possessed by holders of relatively small claims (which could be large entities). As a result, proposals and plans often treat small claims differently from large claims, e.g. by providing for payment in full of claims for $1,000 or less. There is no principled reason for this preference (which also corrupts whatever protection would otherwise be afforded by the head-count test) and it is therefore recommended that it be abolished.

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The recommendation to repeal section 110 of the BIA is linked because it encourages trading in claims by allowing claims to be sub-divided without prejudicing voting rights. If the "head count" test is repealed, Section 110 would artificially and unnecessarily restrict liquidity by making it potentially prejudicial to assign a part of a claim.

Provide that the rule contained in Section 54(3) of the BIA should apply in CCAA cases.

Provide that in connection with the court application to approve a reorganization plan, the applicable insolvency administrator be required to provide an opinion that it is reasonable to expect that any dissenting creditors will not receive less under the plan that they would receive in a liquidation.

Generally speaking, any voting mechanism that relies upon majority rule is susceptible to abuse by related parties or parties who derive collateral benefits from the decisions of the group. The BIA and the CCAA currently give the court considerable discretion to refuse to approve a plan or proposal that has received approval by the requisite majority of creditors, but neither statute provides much guidance as to the manner in which that discretion is to be exercised. Proposal #59 provides that the rule contained in section 54(3) of the BIA be extended to the CCAA and is specifically designed to limit the potential for abuse by related parties. Proposal #60 applies more broadly to protect creditors who form the minority in any given class and ensures that under both the BIA and CCAA that there is evidence that dissenting minority creditors will not be prejudiced by the reorganization plan as compared to a liquidation.

Provide that a court approving a reorganization plan has the power to approve a reorganization of the equity of the debtor, either with or without shareholder approval.

Provide that all claims against a debtor in an insolvency proceeding that arise under or relate to an instrument that is in the form of equity, including claims for payment of dividends, redemption or retraction or repurchase of shares, and damages (including securities fraud claims) are to be treated as equity claims subordinate to all other secured and unsecured claims against the debtor, and which can be extinguished as against the debtor, in the discretion of the court, in connection with the approval of a reorganization plan either with or without the approval of the parties asserting such claims.

It is often useful to reorganize the equity of a debtor in the course of reorganization proceedings. For example, it may be desirable to allow creditors to exchange debt claims for equity of the debtor. Neither the BIA nor the CCAA explicitly grants the court authority to alter the articles or share capital of a corporation. In some circumstances it is possible to combine a plan or proposal arrangement with creditors formulated under insolvency legislation with an arrangement with shareholders that is governed by applicable corporate legislation. However, the relevant provisions of corporate statutes may not permit an arrangement to be approved without the consent of shareholders. That requirement is problematic in cases where the value of the debtorís assets is less than the value of the debtorís outstanding indebtedness, so that its equity has no economic value. In such cases, allowing shareholders to veto an arrangement that would work to the benefit of creditors may give them significant leverage, which translates into an opportunity to extract hostage payments in return for their approval. This is unfair as it allows equityholders to receive benefits that are disproportionate in light of their bargained-for priority of their claims. Proposal #61 would eliminate this inequity.

The principle that equityholdersí recovery in insolvency proceedings should reflect the fact that they initially bargained for claims of lower priority than debt claims also motivates the recommendation in proposal #62 that all claims that arise under or relate to an instrument that is in the form of equity are to be treated as equity claims. A key practical example is shareholder damage claims. A number of Canadian companies have decided to reorganize under U.S. rather than Canadian law because Canadian law does not expressly subordinate shareholder damage claims. As a result, there is concern that the shareholdersí damage claims might rank equally with the claims of the general unsecured creditors which would clearly be an unfair result.

F. PREFERENCES

The BIA currently sets out numerous transactions that are reviewable and may be set aside if they occur during specified periods. These include fraudulent preferences, where the insolvent corporation enters into an eve-of-bankruptcy transaction that involves a conveyance or transfer of property or an obligation incurred, with a view to benefiting one or more creditors at the expense of other creditors. The transaction results in the creditor being placed in a better position that it would have been in liquidation, and involves elements of intention to create a preference. Transactions subject to attack under the BIA also include settlements, which are gifts, transfers, covenants or similar transactions where the debtor is acting to dispose of assets that might be available to satisfy creditorsí claims; and includes elements of intention of the debtor to retain the benefit of the assets. Third are the BIA provisions addressing reviewable transactions, generally transfers for undervalue between not-at-armís-length parties. There are also prohibitions on the corporation redeeming or purchasing for cancellation its own shares or declaring a dividend other than a stock dividend when the corporation was insolvent or where the transaction rendered it insolvent.

The underlying policy reason for these provisions of the BIA is that on insolvency, assets of the debtor should be available to satisfy creditorsí claims, and that particular transactions that have as their objective or effect the defeat of those claims or reduction in the amount of value available to satisfy those claims should be set aside. The policy underlying preferences is that generally, all ordinary creditors should rank equally and none should have a

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preference, and that debtor companies should not act in a manner that unnecessarily depletes assets that would otherwise be available to creditors. The trustee in bankruptcy exercises the remedies on behalf of all creditors.

There are also parallel provisions under provincial assignments, preferences and conveyances legislation that deal with transactions or conveyances without consideration or at under value. They generally address periods both in and outside of insolvency, creating some overlap with federal bankruptcy legislation, with different standards across different provincial jurisdictions. Canadian courts have held that trustees can take advantage of such legislation where there is no conflict with the BIA. This has created some uncertainty for both debtors and creditors in terms of how they structure transactions in a manner that does not offend provincial or federal statutory regimes.

These provisions, while important, are outdated and unnecessarily complex. They specify different periods in which a transaction is "reviewable", and require different tests for the finding of a settlement, reviewable transaction or preference. As a result, it is often difficult for officers of the debtor and for creditors with fewer resources and less information to discern which kinds of transactions are prohibited or the scope of possible remedies. Moreover, there are different standards depending on whether the corporation is insolvent or bankrupt and depending on whether there is a CCAA or BIA proceeding. The result is that it is difficult for debtors to arrange their affairs in a manner that will not violate either federal bankruptcy or provincial conveyances and preference legislation. These recommendations are aimed at codifying and simplifying the existing rights and remedies. They will bring clarity, consistency and predictability to the treatment of these transactions, enhancing access to remedies while protecting valid armís length transactions.

Provide for uniform rules under both the CCAA and BIA for challenging fraudulent preferences, conveyances at under-value and other reviewable transactions (collectively, "reviewable transactions"), with a CCAA monitor or a trustee under a proposal being authorized to exercise the same powers as a trustee in bankruptcy.

Proposal #63 is aimed at creating consistency under the CCAA and the BIA. There would be one set of rules for reviewable transactions, broadly defined as preferences, conveyances, settlements, and other reviewable transactions. Definitions would be clarified to focus on transactions that diminish the value of assets in the estate of the bankrupt debtor, and clarify the underlying reason for the prohibition. Creditors, trustees and receivers will have greater certainty as to the scope of their potential remedies. Uniform review periods and uniform criteria for setting aside such transactions would increase certainty and predictability in terms of tests to be applied and the time frame for which a transaction may be reviewed. The provisions would be aimed at transactions where the debtor company was insolvent or near insolvency, and would provide consistency in the treatment of transactions that affect the quantum of the debtorís assets.

Currently, the BIA specifies that these reviewable transaction provisions apply to proposals, with modifications, except where the proposal provides otherwise. There should be consistency between these provisions and remedies and those afforded to the monitor under the CCAA. Thus, the recommendation suggests that a monitor under the CCAA or a trustee under the proposal would be authorized to exercise the same power as the trustee in bankruptcy can currently exercise on behalf of all the creditors in respect of reviewable transactions under the BIA.

Provide for a complete code in federal insolvency law for challenging reviewable transactions by or on behalf of creditors, so that upon the commencement of insolvency proceedings, provincial laws (including the oppression remedy under corporate law) would no longer apply and a single national standard would be applicable.

Proposal #64 suggests implementation of a complete code in federal insolvency law, so that there would be a national standard for challenging transactions that may affect the value of creditorsí realizable claims. This would assist creditors and the debtor in bringing greater certainty and clarity to the scope of allowable transactions in the period prior to and during insolvency. In turn, there would be greater predictability and thus fewer litigation costs. The rules would be aimed at catching those transactions where the assets or services of the debtor are transferred at conspicuously less than market value. Remedies should be made consistent and should include setting aside the transaction or payment of the equivalent in value to the trustee or monitor. Current provincial conveyances, preferences and assignments legislation would not be available to trustees or monitors. Such legislation would continue to be available to creditors outside of the insolvency context. However, once the corporation is insolvent, the national standards would apply. If the oppression remedy provision contained in proposal #65 is adopted, the federal codification would also eliminate application of oppression remedy provisions under provincial corporation legislation once a corporation commences insolvency proceedings.

This proposal would assist with both fairness and efficiency objectives of the insolvency and bankruptcy regime. It would provide a balance between the rights of creditor-transferees of the debtorís property and the general body of creditors with claims in bankruptcy. It would enhance governance of the corporation during financial distress by providing greater clarity to corporate directors and officers as to the scope of permissible transactions during the review period. A federal code would simplify and bring greater certainty to financing transactions. There would be one forum during insolvency for challenging reviewable transactions by or on behalf of creditors.

Provide for the expansion of Section 100 and/or the adoption of an oppression type remedy to create a more flexible mechanism for dealing with reviewable transactions, subject to creating safe harbour provisions.

Canadian courts for the most part have recognized the ability of creditors to bring oppression remedy applications under the Canada Business Corporations Act and similar provincial corporation legislation. However, the creditor must establish that it is in a position analogous to a minority shareholder before the court will generally allow the case to proceed. An oppression provision under the BIA could contain the same standard as corporationsí statutes, specifically, that the remedy is available where the directors and/or officers of the corporation acted in a manner that was

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oppressive, unfairly prejudicial to or unfairly disregarded the interests of creditors. The provision would be tempered by a safe harbour provision, creating a balance between the ability of the debtor to make business decisions in the period before and during the firmís financial distress and the ability of creditors to obtain a remedy where the conduct is oppressive, unfairly prejudicial to or unfairly disregards their interests.

This could be accomplished by expanding the remedies under s. 100 of the BIA, the reviewable transactions provision, or by creating a separate oppression remedy provision under the BIA that applies once a corporation enters insolvency proceedings. Provincial oppression provisions would no longer apply, creating a national standard that would apply to governance of insolvent corporations.

Provide for the continuation of the English subjective test for preference provisions.

There is some debate as to whether the BIA should retain the current test for preference provisions, which is one of establishing that the transaction was made "with a view to" preferring a creditor, i.e. a subjective intention test. Other jurisdictions have moved away from this approach to a standard of assessing the effect of the transaction on the position of creditors with claims in bankruptcy. The difficulty is that transactions made in good faith are not necessarily protected from an "effects-based" standard, as all preferences in the review period would be caught. Thus, this recommendation suggests that the scheme should still protect good faith transactions where there was no intention to defeat the claims of creditors. This standard strikes a balance between the ability of the debtor to conduct its affairs in the period prior to the commencement of insolvency proceedings and the ability of trustees, receivers and creditors to recover value where a transaction has given a preference contrary to the statute. It protects creditors who engage in armís length transactions for value and did not know or could not reasonably be expected to know that the debtorís actions had the effect of diminishing the amount available to satisfy creditorsí claims.

Provide specific safe harbour provisions for certain transactions involving financiers unrelated to and dealing at armís length with the debtor, including:

eligible financial contracts;

sales pursuant to securitizations;

security given before, or as condition of, making advances including security delivered on margin calls, unless a material portion of proceeds of advances are used to repay unsecured obligations owed to the lenders or are otherwise received by the lenders or parties related to the lenders; and

guarantees from parent corporations of borrowings by its direct or indirect subsidiaries.

This proposal is aimed at protecting specified creditors who grant the debtor financing within review periods, but who are acting at armís length. The proposal would provide a safe harbour to such transactions. It will create greater certainty in financing transactions. It recognizes that there are instances in which fairness and commercial efficiency should recognize the validity of such transactions. The safe harbour would provide protection from these transactions, balanced against the ability of existing or future creditors to realize on their claims.

Provide that the court has the power to reduce or eliminate waiver fees, forbearance fees, work fees, default interest and other additional compensation paid to lenders and other creditors of the debtor within a specified period prior to the commencement of an insolvency proceeding as a result of defaults or expiry of credit facilities, if the court concludes such compensation was manifestly excessive in relation to additional risk and time being incurred or consideration provided by the creditors.

This proposal is aimed at creating some balance to prevent lenders from using commercial leverage to obtain unfair compensation for debtors which are insolvent or in the vicinity of insolvency. It balances the ability of the debtor to negotiate additional financing with remedies where the financing has extracted hostage type payments such as excessive waiver fees, forbearance fees or other compensation that is manifestly excessive in the circumstances of the lending decision, and that therefore reduces the value of assets available to meet creditors' claims. Some creditors, because they are strategically important to the debtor, are able to extract numerous kinds of additional compensation from the debtor, excessive in relation to the consideration provided or any additional risk incurred by the creditor. The review would be limited to a specified period prior to the commencement of insolvency proceedings. Codifying the courtís jurisdiction in this respect would impose some discipline and curb possible abuse by instilling concern in parties that these types of fees or compensation may be subject to scrutiny of the court and subject of an order reducing or setting them aside if they are manifestly excessive in the circumstances.

Provide that there is no doctrine of equitable subordination in Canada.

The U.S. doctrine of equitable subordination allows superior courts to exercise their equitable jurisdiction to subordinate claims that are valid against the insolvent debtorís estate but arise from, or are connected with, inequitable conduct prejudicial to the interests of creditors. Canadian courts have not yet clarified whether the doctrine applies to the Canadian insolvency context. Proposal #69 specifies that the doctrine of equitable subordination would not be applicable to reviewable transactions in the Canadian context, thus creating some certainty for parties in their financing transactions.

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Provide for conflict of law rules with respect to reviewable transactions modelled after the PPSA conflict of law rules.

This proposal is aimed at specifying conflict rules in respect of reviewable transactions. The current PPSA regime has worked well in resolving priority issues in terms of registration, perfection and resolution of conflict of laws. The BIA and CCAA should be amended to provide the same kind of certainty, while respecting current provincial conflict of law rules.

G. PRIORITIES

Provide that the BIA priority rules should apply in BIA and CCAA proceedings and also in the receiverships of insolvent entities.

The BIA creates an extensive priority scheme. However, that scheme does not apply in the case of CCAA proceedings. Nor does it apply to receiverships. Provinces have created statutory security interests and deemed trusts which give wage claims priority over the claims of secured creditors. However, in most cases these measures do not apply in bankruptcy because the BIA provisions take precedence over the provincial legislation. In relation to Crown claims, BIA, ss 86-87 (status of Crown claims and statutory Crown securities) apply in the case of bankruptcy and BIA reorganization proceedings. They do not apply to CCAA reorganization proceedings. Nor do they apply to receiverships. BIA, s.67(2) and (3) (deemed trusts) is limited to bankruptcy.

There is no justification for these discrepancies. Typically, the debtor will be insolvent or near insolvency by the time a secured creditor appoints a receiver. Why should the relative entitlements of the secured creditor and creditors with preferred bankruptcy claims vary depending on the form of the insolvency proceeding? The problem can be addressed by making the bankruptcy priority rules apply to receiverships where the debtor is insolvent.

The case for extending the bankruptcy priority rules to CCAA and BIA reorganization proceedings is similar. Creditorsí relative entitlements should not vary depending on the nature of the proceedings. It is inconsistent to recognize preferred claims in one context but not another. Inconsistent rules encourage opportunistic behaviour on the part of the debtor or of individual creditors that may be prejudicial to the interests of the creditors as a group.

Provide that source deductions should have automatic priority over all secured claims with respect to inventory and accounts receivable, other than purchase money security interests, but not as against other secured claims.

Our proposal is that source deductions should have automatic priority over all claims with respect to inventory and accounts receivable, other than purchase-money security interests, but not as against other secured claims. The effect of this reform would be to return to what many thought was the state of law prior to the decision in Royal Bank of Canada v. Sparrow Electric Corp. [1997] 1 S.C.R. 411. It is reasonable that source deductions shall have priority with respect to inventory and receivables since these assets are generated through the on-going efforts of the employees. Furthermore, it is practical for operating lenders to protect themselves from the priority risk. However, it is not practical for term lenders on fixed assets to protect themselves against the risk, so the current rules create inefficiencies in the lending markets.

Provide that current priorities with respect to wage claims should be maintained, with clarification that pension contributions are included in wages for the purposes of the BIA.

BIA, s.136(1)(d), subject to the rights of secured creditors, gives employees a preferred claim in a debtorís bankruptcy of up to $2,000 for unpaid wages, salary and like entitlements earned in the six months immediately preceding the bankruptcy. There have been extensive debates over the years whether this protection is sufficient. Various schemes for enhanced protection, including in effect compulsory insurance schemes, have been proposed over the years but have not proceeded.

In our view, the case for giving wage claims higher priority than they presently have has not been made. This issue has been studied and commented upon extensively in the past. It has probably received more attention in Canada than any other insolvency issue. Our proposal is for the current priorities with respect to wage claims to be maintained, subject to clarification that pension contributions are included in wages for the purposes of the BIA.

Provide that existing 30-day suppliersí rights should be repealed entirely.

Provide that if the existing 30-day rights are retained, the existing provisions should be left unamended except to foreclose the possibility of greater revendication and resolution rights arising under provincial law during the course of insolvency proceedings.

As part of the November 1992 BIA amendments, the Canadian government enacted ss 81.1 and 81.2 to protect unpaid suppliers. Section 81.1 was largely inspired by the Quebec Civil Law relating to thirty (30) day goods. Oddly enough, in its reform of the Quebec Civil Code which came into force on January 1st 1994, the Quebec legislation substantially modified the conditions relating to thirty (30) day goods, considerably reducing, if not almost

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eliminating, the rights of unpaid suppliers to revendicate thirty (30) day goods.

It is the view of our organizations that there is no justification for preferring suppliers over other unsecured creditors. Further, experience has shown that since they came into force, ss 81.1 and 81.2 have reduced the borrowing capacity of certain businesses without at the same time having conferred on unpaid suppliers all the protection they may initially have sought.

In our view, there is no case for increasing further the protection of unpaid suppliers in bankruptcy. On the contrary, there is a strong case for removing the special preference for suppliers of goods altogether. If that protection is to be retained, it should be left unamended except to foreclose the possibility of greater revendication and resolution rights arising under provincial law during the course of insolvency proceedings.

Since the issue of giving suppliers special preference is an issue that has received more attention than most issues in Canadian insolvency law, we have decided to limit our comments in this paper to a clear statement of our position.

Provide that the insolvency statutes should expressly recognize voluntary contractual subordination and provide that subordination can be enforced during the course of insolvency proceedings by the debtor, applicable insolvency administrators or other creditors notwithstanding third party beneficiary/privity of contract rules.

There is uncertainty in Canada concerning the circumstances when voluntary contractual subordination can be recognized and who can enforce it. In Canada, the provincial personal property security statutes address subordination of security interests in personal property, and they either state or imply that third parties may enforce a subordination agreement in their favour even though they are not a party to that agreement. These are non-bankruptcy rules. Neither the CCAA nor the BIA says anything about the enforceability of subordination agreements inside bankruptcy. There is a need for clarification. The insolvency statutes should expressly recognize contractual subordination of both real and personal property security, and of the priority of payment of unsecured claims, and provide that those subordinations can be enforced during the course of insolvency proceedings by the debtor, applicable insolvency administrators or other creditors, notwithstanding third party beneficiary/privity of contract rules. This would give effect to the reasonable expectations of creditors.

H. BANKRUPTCY REMOTENESS/RISK MANAGEMENT

Provide that a business trust is subject to liquidation under the BIA, but cannot be reorganized.

This proposal is designed to clarify that trusts used as financing vehicles can be liquidated under the BIA but cannot be reorganized.

Provide that a corporation that is designated as a special purpose vehicle in its constating documents, has no employees and has no assets other than financial assets relating to a specific financing transaction and publicly traded securities, cannot be subject to consolidated reorganization proceedings or a consolidated reorganization plan under the CCAA or BIA.

This proposal is designed to support the use of special purpose vehicles in order to facilitate bankruptcy remoteness with respect to pure financing transactions that do not affect a going concern business.

Provide that financiers unrelated to and dealing at armís length with the debtor are not stayed in reorganization proceedings from enforcing security over marketable securities for amounts owing under an eligible financial contract.

This proposal is designed to facilitate the collateralized swap market.

Provide that an agreement between a senior creditor and a subordinate creditor entered into at the time of the subordinate creditorís financing giving the senior creditor the power to control the vote of the subordinate creditor in a reorganization is enforceable, unless the subordinate creditor satisfies the court that the terms of the reorganization plan with respect to the subordinate creditor are manifestly unjust.

The purpose of the proposal is to facilitate venture capital financings on a subordinate, secured basis while giving the court the power to prevent abuse.

I. ONE STATUTE OR TWO?

Provide that there shall continue to be two reorganization systems, one for big companies (CCAA) and one for

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smaller corporations and other entities (BIA proposals).

Provide that a CCAA monitor shall make the following filings with the Superintendentís Office for record keeping purposes:

initial CCAA order within 10 days;

debtorís initial list of creditors within 30 days;

if a reorganization plan is consummated, a copy of the plan, the sanction order and a brief statement of affairs within 30 days; and

if all or substantially all of the debtorís business is sold during the course of the proceeding, a brief statement of affairs within 30 days of closing.

Canadaís experience with two reorganization systems has generally been positive. The principal virtue of the two-system approach is that it responds to the fact that different types of reorganization legislation are appropriate for different types of debtors. Experience has shown that larger debtors are generally better served by the relatively flexible CCAA, whereas smaller debtors are generally better served by the BIA, which is relatively detailed and inflexible. Proposal #81 suggests that this basic feature of contemporary Canadian insolvency law be retained. However, this general principle should not preclude harmonization of specific provisions of the CCAA and the BIA. For example, we recommend above that the BIAís provisions dealing with reviewable transactions be included in the CCAA. Similarly, proposal #82 suggests that filing requirements similar to some of those found in the BIA be added to the CCAA in order to facilitate retrieval, analysis and dissemination of information about proceedings under the latter statute.

J. INCOME TAX

Provide that distress preferred share treatment for tax purposes can be afforded for a specified period of time to qualifying debt by simply filing a notice of election without any need to actually convert the debt into preferred shares.

An insolvent debtor can, in certain circumstances, be eligible to convert debt into "distress preferred shares". Distress preferred shares qualify for special treatment under the Income Tax Act (ITA). Dividends on the shares received by a Canadian corporation are not taxable when computing income tax, thus providing a lower cost means of financing a restructuring, in turn promoting the restructuring goals of insolvency legislation.

However, as currently structured, the creation of distress preferred shares is very costly. In many cases, there is a need for complex transactions or creation of special purpose corporate entities to assign the debt to and then undertake the conversion to preferred shares. There is also the need for intricate tax rulings from the Canada Customs and Revenue Agency sanctioning these complex arrangements. These requirements contribute enormous cost and delay in devising and approving a restructuring plan. In a low/moderate interest rate environment, the transaction costs associated with creation of distress preferred shares can become too high to take advantage of the ITA provisions. This potentially creates significant barriers and reduces the availability of an important avenue for workout financing. In turn, this is likely to have a negative impact on the potential for restructuring and the rehabilitative objectives of the legislation.

Proposal #83 would allow a creditor and an insolvent debtor to elect to treat a loan as if distress preferred shares had been issued. It is facilitative in nature and aimed at both fairness and efficiency in complying with current tax policy. It does not require any change in tax policy nor does it change the ITA requirements for qualifying for the tax benefit of distress preferred shares. Rather, the election is aimed at making use of distress preferred shares more accessible, with benefits to both the debtor and creditors. Instead of requiring an elaborate set of corporate and financing transactions in order to convert the debt into distress preferred shares, parties could simply file a notice of election. Tax authorities could still make rulings on whether the transaction qualified under the ITA provisions relating to distress preferred shares, but the proposal would eliminate the need for highly complex structured transactions and equally intricate tax rulings.

Costs would be substantially reduced, allowing both creditors and the debtor to make use of this tool to promote going concern solutions where possible. It would also reduce delay in financing decisions and tax rulings and thus enhance access to this form of financing a restructuring. In turn, this would promote the rehabilitation objectives of the legislation.

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Provide that upon consummation of a plan of arrangement, the debtor can elect to use fresh start accounting for tax purposes as if it were a new taxpayer (including valuing its assets at fair market value), with prior tax obligations being dealt with as pre-filing claims.

This recommendation relates to a policy change that would facilitate restructuring in some circumstances. Currently, the conversion of debt to equity can trigger debt forgiveness to the extent that the fair market value of the equity is less than the face amount of the debt. The financial implications of the debt forgiveness rules can effectively block a reorganization. This creates pressure on the debtor to sell the assets rather than reorganize because the purchaser can take advantage of the more favourable tax rules applicable to an asset purchase. Yet tax policy should be neutral as between a choice of the debtor company restructured or a new corporation acquiring the business assets, and thus the same tax treatment should be available in either situation. The provision would allow the debtor to elect fresh start accounting for tax purposes as if it were a new taxpayer, including valuing its assets at fair market value, from the moment that the restructuring plan is approved and effective. This proposed change promotes both fairness and efficiency. The debtor would give up pre-filing tax attributes, but would be allowed a fresh start in accounting for the tax value of its assets. This would bring into line the rehabilitative objectives of tax policy and of insolvency legislation and afford the debtor an enhanced ability to turn around its financial affairs.

K. INTERNATIONAL INSOLVENCIES

The object of international insolvency laws is to achieve co-operation between states in the management of insolvency proceedings in cases where, for example, the debtor has assets in more than one state or where some of the debtorís creditors are from out of the state where the insolvency proceedings are taking place: UNCITRAL Secretariat, Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency [1997] XXVIII UNCITRAL Year Book, pt 3, s.2, U.N. Doc. A/CN.9/442 ("UNCITRAL Model Law Guide"), para.1. International insolvency laws can facilitate the management of international insolvency proceedings in a number of ways, for example, by:

providing access for the person administering a foreign insolvency proceeding ("foreign representative") to the courts of the enacting state, thereby permitting the foreign representative to seek a temporary ëbreathing spaceí, and allowing the courts in the enacting state to determine what co-ordination among the jurisdictions or other relief is warranted for optimal disposition of the insolvency;

determining when a foreign insolvency proceeding should be accorded ërecognitioní, and what the consequences of recognition may be;

providing a transparent regime for the right of foreign creditors to commence, or participate in, an insolvency proceeding in the enacting state;

permitting courts in the enacting state to co-operate more effectively with foreign courts and foreign representatives involved in an insolvency matter;

authorizing courts in the enacting state and persons administering insolvency proceedings in the enacting state to seek assistance abroad;

providing for court jurisdiction and establishing rules for co-ordination where an insolvency proceeding in the enacting state is taking place concurrently with an insolvency proceeding in a foreign state;

establishing rules for co-ordination of relief granted in the enacting state in favour of two or more insolvency proceedings that may take place in foreign states regarding the same debtor".

((UNCITRAL Model Law Guide, para.3).

There are two opposing principles that define the scope for co-operation in the management of international insolvency proceedings:

universalism; and

territorialism.

Universalism is based on the proposition that a multinational debtorís home state should have world-wide jurisdiction over the bankruptcy. In a universalist system, all the debtorís assets would be administered in the one insolvency proceeding no matter where in the world they were located. An insolvency proceeding commenced in one state would have effect in all other states.

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Territorialism is based on the proposition that each state has the exclusive right to govern within its own borders. The territorialism approach begins with the rule that the effects of an insolvency proceeding do not reach further than the sovereignty of the state where the insolvency proceeding is begun. The effects are limited to the territory of that state: Andre J. Berends, "The UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview" (1998) 6 Tulane Journal of International and Comparative Law 309 at pp 313-314.

Universalism and territorialism both have advantages and disadvantages. Territorialism has disadvantages from a creditorís perspective. If the debtor is bankrupt, it means that separate proceedings will have to be brought in each state where the debtor has assets. There will be multiple trustees and multiple sets of administration costs. If the debtor has made a reorganization proposal, the problems of co-ordinating the separate proceedings in each jurisdiction may prevent a successful outcome. When a creditor files a claim in several proceedings, there is a possibility that the claim will be recognized in one proceeding but refused in another. Under a system where claims have to be filed in more than one proceeding, large multinationals have an advantage over small creditors for whom it may be too complicated and costly to file a claim abroad. On the other hand, under universalism in its pure form, a state runs the risk that a foreign trustee may assume control over the debtorís assets and remove them to the trusteeís home state. As a result, assets that could have been distributed among local creditors may end up in foreign hands: Berends, supra, at p. 314.

There would be no need for rules of co-operation in the management of international insolvencies under either a pure universalism or a pure territorialism regime. Under pure universalism, there would be no need for rules of co-operation because there would be only one court (in the debtorís home state) applying uniform (international) bankruptcy laws. Under pure territorialism there would be no place for rules of co-operation because pure territorialism implies absolute state autonomy. In practice, however, no state applies either the universalism principle or the territorialism principle in its pure form. Pure universalism is unachievable unilaterally, while pure territorialism is impractical in a global economy. Therefore every domestic insolvency law is a mixture of the two principles: Berends, supra, at p.314. Canada is no exception. The prevalence of hybrid bankruptcy principles means that some form of co-operation between states in the management of international insolvency proceedings is unavoidable.

International insolvency laws or rules for the management of international insolvency proceedings are a matter of domestic law. Different states have different rules. There are six main categories:

Countries with specific legislation providing for mandatory recognition of foreign insolvency proceedings opened in certain specified countries;

Countries with express legislation providing for selective recognition or a practice of discretionary recognition;

Countries that feature a practice of discretionary recognition;

Countries that are signatories to multilateral treaties dealing with access and recognition;

Countries with legislation based on the principle of strict territoriality but with differing practice; and

Countries that are wholly territorial.

(Expert Committeeís Report on Six Categories of Domestic Insolvency Law at Toronto Colloquium of UNCITRAL and the International Association of Insolvency Practitioners (March 1995), quoted in Berends, supra, at p.315).

There is a case for harmonization of the rules:

"The increasing incidence of cross-border insolvencies reflects the continuing global expansion of trade and investment. However, national insolvency laws have by and large not kept pace with the trend, and they are often ill-equipped to deal with cases of a cross-border nature. This frequently results in inadequate and inharmonious legal approaches, which hamper the rescue of financially troubled businesses, are not conducive to a fair and efficient administration of cross-border insolvencies, impede the protection of the assets of the insolvent debtor against dissipation, and hinder maximization of the value of those assets. Moreover, the absence of predictability in the handling of cross-border insolvency cases impedes capital flow and is a disincentive to cross-border investment"

((UNCITRAL Model Law Guide, supra para.13).

The United Nations Commission on International Trade Law (UNCITRAL) adopted the text of a model law on Cross-Border Insolvency in May 1997. The Model Law provides rules on matters such as:

The recognition and enforcement of foreign insolvency proceedings;

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Access of foreign representatives to the courts of states that enact the Model Law;

The rights of foreign creditors;

Co-ordination of multiple insolvency proceedings; and

Co-operation between:

courts,

representatives, and

courts and representatives.

The Model Law is based on the following general principles:

The court of each enacting state shall recognize only one foreign proceeding as a foreign main proceeding.

The recognition of a foreign proceeding shall not restrict the right to commence a local proceeding.

A local proceeding shall prevail over the effects of a foreign proceeding and over relief granted to a foreign representative, regardless of whether the local proceeding was opened prior to or after the recognition of a foreign proceeding.

When there are two or more proceedings, there shall be co-operation and co-ordination.

A foreign proceeding shall be recognized as a foreign main proceeding if the foreign proceeding is opened in the state where the debtor maintains the centre of his main interests. A foreign proceeding shall be recognized as a foreign non-main proceeding if the foreign proceeding is opened in a state where the debtor has an establishment.

Upon recognition of a foreign proceeding as a foreign main proceeding, some types of relief will come into effect automatically. They will be in effect until modified or terminated by the court. Upon recognition of a foreign proceeding as a foreign main proceeding, some other types of relief may be granted by the court, but they will not come into effect automatically. Upon recognition of a foreign proceeding as a foreign non-main proceeding, relief can only come into effect if it is granted by the court.

Co-ordination may include granting relief to the foreign representative. In granting relief to a foreign representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets falling under the authority of the foreign representative.

Creditors shall be allowed to file claims in any proceeding. Payments to creditors from multiple proceedings shall be equalized.

If there are surplus assets of a local non-main proceeding, they shall be transferred to the main proceeding.

(Berends, supra, at pp 321-322).

The following are the most important rules in the Model Law.

A foreign representative has direct access to the judicial authorities of the enacting state.

As soon as a foreign representative has filed an application for recognition of the foreign proceedings, the court of the enacting state may grant relief of a provisional nature.

The foreign proceeding must be recognized in the enacting state once certain threshold requirements are met. These relate to such matters as:

the nature of the foreign proceeding (whether the foreign proceeding is a foreign main proceeding or a foreign non-main proceeding);

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the foreign representative;

the request;

the competence of the court in the enacting state.

Recognition has a number of automatic effects when the foreign proceeding is recognized as a foreign main proceeding. The automatic effects are meant to be temporary until the court of the enacting state modifies them.

When the foreign proceeding is recognized as a foreign non-main proceeding, there are no automatic effects. The court of the enacting state has discretionary power to grant relief.

(Berends, supra, at pp 322-323).

The Model Law also contains rules on co-operation between judicial authorities and representatives and co-ordination of multiple proceedings. The rules governing co-ordination of multiple proceedings are complex, but they can be reduced to the following propositions.

"(1) Effects of a foreign proceeding must always be adjusted to the effects of a local proceeding.

(2) Effects of a foreign non-main proceeding must always be adjusted to the effects of a foreign main proceeding.

(3) Effects of more than one non-main proceeding must be adjusted to each other"

(Berends, supra at p.387).

BIA, Part XIII governs international insolvencies. It deals with the following matters:

the co-ordination of BIA bankruptcy and reorganization proceedings with bankruptcy or insolvency proceedings that have been commenced in a foreign jurisdiction;

co-operation between courts in BIA bankruptcy or reorganization proceedings and foreign proceedings;

the rights of a foreign representative to commence or participate in BIA bankruptcy or reorganization proceedings;

the granting to a foreign representative of local relief in respect of bankruptcy or insolvency proceedings in a foreign jurisdiction; and

the recognition in BIA bankruptcy or reorganization proceedings of foreign insolvency orders and foreign representatives.

BIA, Part XIII is similar to the Model Law in the following principal respects:

both provide for the recognition of foreign representatives and the granting of local relief;

both provide for co-ordination and co-operation between courts, but without prescribing particular steps the courts must take;

in granting local relief to foreign representatives, both laws contemplate that the relief will be aligned with the relief available in comparable local proceedings. This means there is no need under either law to modify or replace substantive domestic bankruptcy laws; and

both laws restrict the scope of local proceedings once foreign proceedings have been commenced or recognized.

(Marvin Baer, The Impact of Part XIII of the BIA and the UNCITRAL Model Law on Cross-Border Insolvency (1977) (unpublished paper prepared for Industry Canada, Corporate Law Policy Directorate, February 1998) (the "Baer paper"), Part VIII).

BIA, Part XIII is different from the Model Law in the following main respects:

The Model Law has detailed rules for the recognition of foreign proceedings. The effects of recognition vary depending on

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whether the foreign proceeding is a foreign main proceeding, a foreign non-main proceeding or other foreign proceeding. BIA, Part XIII has no detailed rules on recognition.

The Model Law limits the courtís capacity to recognize foreign proceedings by reference to the connecting factors set out in the definitions of "foreign main proceeding", "foreign non-main proceeding" and "foreign proceeding". BIA, Part XIII imposes no corresponding limitations.

BIA, Part XIII has liberal rules for the recognition of foreign proceedings. In contrast to the Model Law, it draws no distinction between foreign main proceedings and foreign non-main proceedings.

On the other hand, Part XIII permits recognition only for the limited purposes of allowing the court to:

limit local proceedings: s.268(2);

seek assistance from foreign authorities: s.271(1); and

seek co-ordination of local and foreign proceedings: s.268(3).

The Model Law attaches wider effects to recognition, particularly for foreign main proceedings. Under the Model Law, the recognition of foreign proceedings is mandatory provided that certain threshold requirements are met. BIA, Part XIII gives the court a discretion.

CCAA, s.18.6 is a shortened version of BIA, Part XIII. It deals with the following matters:

the co-ordination of CCAA proceedings with bankruptcy or insolvency proceedings in a foreign jurisdiction;

co-operation between courts in CCAA proceedings and bankruptcy or insolvency proceedings in a foreign jurisdiction; and

applications by a foreign representative in CCAA reorganization proceedings.

There are no express provisions allowing a foreign representative to apply for a local stay in respect of foreign proceedings, but that may be unnecessary given the wording of CCAA, s.11. Nor is there any provision equivalent to BIA, s.268(2) limiting the effect of local proceedings to local assets: Baer paper, supra Part VIII..

Consider retaining the existing international provisions of the CCAA and the BIA with minor amendments since in substance they have worked successfully.

As a practical matter, the vast majority of Canadaís international insolvencies involve the United States. Furthermore, the United States and Canada have two of the strongest reorganization cultures in the world. As a result, practices have developed relying on the existing statutory provisions of the laws of both countries which, in the general assessment of practitioners, work effectively. These practices are unique, and appropriately reflect the business, governmental, social and legal cultures of both countries. Furthermore, they facilitate the operation of the lending markets in Canada by establishing a reasonable level of assurance that Canadian laws will be applied to truly Canadian financing transactions. As a result, there is no pressing need for comprehensive reform of the existing international provisions.

Whether the existing law is retained or the Model Law is adopted, provide for new provisions to ensure that Canadian creditorsí interests are properly represented in any foreign proceeding by providing that as a condition precedent to the recognition by the court of foreign insolvency proceedings, the court must either appoint a creditorís committee or a licensed trustee as a monitor with the powers stipulated by the court, and ensure provisions are in place to provide the creditorsí committee or monitor with reasonable funding.

However, if Canada does decide to adopt the Model Law, the legislation should incorporate provisions to protect the interests of Canadian creditors particularly in the case of foreign main proceedings outside Canada. Article 21(2) of the Model Law provides that upon recognition of a foreign proceeding, whether main or non-main, the court may at the request of the foreign representative entrust the distribution of the debtorís local assets to the foreign representative, but the court must first be satisfied that the interests of local creditors are adequately protected. Article 22(1) provides that in granting or denying relief under article 19 or 21, the court must be satisfied that the interests of creditors and other interested persons, including the debtor, are adequately protected. Both these provisions are directed to the local court. There is nothing in the Model Law that expressly requires the foreign court to protect the interests of local creditors and other local interested persons. The distance factor, coupled with the cost of legal

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representation, may inhibit the effective participation of Canadian creditors in foreign proceedings. A possible solution would be an amendment to provide that when a foreign main proceeding is recognized in Canada, a Canadian creditorís committee must be appointed. The order for recognition would be conditional on the appointment of a committee. The committee would be funded out of the foreign main proceedings and entitled to appoint legal counsel and financial advisers if necessary. The role of the committee would be to ensure that Canadian creditors were treated fairly and equitably in the foreign main proceedings. Procedures would be necessary to ensure that the committee was properly constituted to reflect the interests of Canadian creditors.

A creditorsí committee might not be worth the cost in all cases. Therefore, the requirement should not be a mandatory one. A less expensive alternative to a creditorsí committee might be to provide for the appointment of a monitor with standing to represent the interests of Canadian creditors in the foreign main proceedings. Model Law, article 27 is relevant in this connection. It allows the local court to appoint a person or body to act at the direction of the court for the purpose of achieving co-operation between the foreign and local courts and representatives. Taking all these considerations into account, the best solution would be a provision that requires the interests of Canadian creditors to be represented but leaves the choice of mechanism to be determined on a case-by-case basis. The provision would say that before a Canadian court recognizes a foreign main proceeding it must satisfy itself that the interests of Canadian creditors will be adequately represented through adoption of one or other of the measures outlined above or other means.

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