

Harmonizing Cross-Border Restructuring

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Introduction

In this age of global commerce, the collapse of a multinational corporation can trigger the restructuring laws of several jurisdictions. This raises a host of potential procedural and substantive conflicts. However, it also raises an opportunity for the courts, the debtor and other stakeholders to co-operate across jurisdictional lines to work efficiently and increase realizations for stakeholders in competing jurisdictions. The following work examines some of the key areas in which two jurisdictions, Canada and the US, have harmonized restructuring proceedings.

The Legislative Framework

Canada's *Companies' Creditors Arrangement Act* ("CCAA")¹ and *Bankruptcy and Insolvency Act* ("BIA")² both recognize foreign restructuring proceedings. So, when a debtor with operations or assets in Canada has commenced *Chapter 11* proceedings in the US, interested parties generally seek a corresponding stay of proceedings or commence a corresponding restructuring proceeding in Canada under the CCAA. The CCAA gives Canadian judges presiding over "foreign restructuring proceedings" wide discretion to tailor the orders issued in the course of CCAA proceedings to the particular restructuring. Though generally restricted to bankruptcy and reorganization proceedings of smaller companies, the BIA contains similar, albeit more detailed, provisions concerning debtors in foreign proceedings.

(a) Section 18.6 of the CCAA

Canadian courts may issue under section 18.6 of the CCAA a stay where foreign proceedings have been commenced, a "foreign proceeding" being defined as "a judicial or administrative proceeding commenced outside Canada in respect of a debtor under a law relating to bankruptcy or insolvency and dealing with the interests of creditors generally."³

This section authorizes Canadian courts to grant any relief appropriate to help co-ordinate CCAA proceedings with foreign insolvency proceedings. This includes formally recognizing foreign orders and helping foreign representatives in for-

ign restructuring proceedings, as long as neither is inconsistent with the CCAA's provisions and Canadian law.

Courts may consider many factors in applying section 18.6. In *Re Babcock & Wilcox Canada Ltd.*,⁴ the Ontario Superior Court of Justice (the "Ontario Court") outlined the factors courts should consider. In *Babcock*, the court was asked to recognize *Chapter 11* proceedings and Babcock's US parent and related companies commenced to stay asbestos-related claims. In granting the requested relief, the Ontario Court considered the need to:

- encourage comity and co-operation between courts of various jurisdictions;
- respect foreign insolvency regimes, unless they are significantly different from Canada's regime in substance or process;
- treat all stakeholders equitably and, where reasonably possible, treat all common stakeholders equally regardless of jurisdiction;
- permit the enterprise to reorganize as a global unit, and where reasonably practicable, permit one jurisdiction to take principal charge of administering the reorganization;
- provide courts having an ancillary role with information to keep apprised of developments in the foreign jurisdiction and give stakeholders appropriate access to proceedings in the principal jurisdiction;
- give all affected stakeholders effective notice as reasonably possible, with an opportunity to apply to the court for appropriate relief; and
- recognize that the extent of a court's role and jurisdiction will vary depending on the debtor's connection to that jurisdiction.

Concerning the latter factor, to determine a jurisdiction's appropriate level of involvement, courts should consider:

- where the debtor's stakeholders and principal operations, undertaking and assets are located;
- how developed each jurisdiction's law is in respect to addressing the debtor's specific problem;

- whether the substantive and procedural law that may be applied would cause undue prejudice; and
- other factors appropriate under the circumstances.

(b) Part XIII of the *BIA*

To qualify for relief under Part XIII of the *BIA*, the debtor must be insolvent and own property in Canada. A certified copy of a foreign court's order is sufficient proof of insolvency.⁶ Like the *CCAA*, the *BIA* grants Canadian courts discretion to issue the relief they consider appropriate to co-ordinate *BIA* proceedings with any foreign proceeding.⁷ The *BIA* explicitly mandates that a foreign stay in a "foreign proceeding" will not apply to creditors residing or conducting business in Canada unless a stay order is issued in Canadian proceedings.⁸

When recognizing "foreign proceedings," Canadian courts see comity as requiring affected jurisdictions to co-ordinate efforts rather than forcing the reciprocating jurisdiction to simply implement the foreign court's decisions. Canadian courts will not generally surrender jurisdiction over restructurings; rather, the courts usually invoke the Canadian restructuring system, even if in an ancillary role. Accordingly, parties involved in *Chapter 11* proceedings need to involve Canadian courts in any cross-border restructuring process early on to ensure that Canadian principles and process are sufficiently considered and integrated to maximize the benefits of either the *CCAA* or *BIA*.

(c) S. 304 "Ancillary Proceedings"

In some cross-border restructurings, the Canadian courts have jurisdiction over the bulk of the debtor corporation's assets and liabilities and the principal restructuring proceeding is initiated in Canada. In these cases, the US Bankruptcy Court is asked to grant an order under section 304 of the *US Bankruptcy Code*⁹ to allow a "foreign representative" in the Canadian restructuring proceeding to petition the US Bankruptcy Court to commence an "ancillary proceeding." The restructurings of Air Canada¹⁰ and Stelco Inc.¹¹ are two recent examples of this process.

To initiate an "ancillary proceeding" under section 304, the foreign representative must establish that the relief sought is the most economical and expeditious way to administer the corporation's estate and that, in accordance with the following principles of s. 304(3)(c), it:

- treats all who hold claims against or interests in the debtor's property justly;
- protects US claim holders against prejudice and inconvenience in processing their claims in the foreign proceeding;

- prevents preferential or fraudulent dispositions of the debtor's property;
- distributes proceeds of the debtor's property substantially as an order under the US Bankruptcy Code would;
- respects comity; and
- provides the debtor with a fresh start, where appropriate.

Recent restructuring cases suggest that, in determining whether Canada is the appropriate venue for principal insolvency proceedings, the US Bankruptcy Court will grant a s. 304 order only where it is satisfied that a Canadian court should in fact have primary jurisdiction. In the cross-border restructuring of Fantom Technologies, Inc.,¹² Fantom and its subsidiaries, which included three Delaware corporations, started proceedings in Canada under the *CCAA*. When ancillary proceedings were sought under the *US Bankruptcy Code's* section 304 to recognize the *CCAA* proceedings, the US court questioned whether the *CCAA* proceeding constituted a "foreign proceeding" under s. 304. To qualify under s. 304, a "foreign proceeding" must be commenced in a country where the debtor's domicile, residence, principal place of business or principal assets were located when the proceedings commenced. In *Fantom*, the court considered whether to exercise only ancillary jurisdiction or to restructure the US subsidiaries under Chapter 11 proceedings in Delaware with the US Bankruptcy Court having principal jurisdiction. Once satisfied that a substantial nexus existed between the US subsidiaries and Canada, the US court held that Canada was the logical jurisdiction for the primary proceedings and granted the relief requested under s. 304.¹³

Procedural Harmonization

When restructuring proceedings have been filed in both Canada under the *CCAA* and the US under *Chapter 11*, the two jurisdictions often adopt guidelines to harmonize their activities, foster efficiency and ensure stakeholders in each jurisdiction are treated consistently.

Many Canadian courts have adopted the American Law Institute's Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases (the "Guidelines"). Also adopted by The International Insolvency Institute for use in certain cases where adequate notice is given to affected parties, the Guidelines encourage co-operation in international cases. However, they are "not intended to alter or change the domestic rules or procedures that are applicable in any country, and are not intended to affect or curtail the substantive rights of any party in proceedings before the courts."¹⁴

The Guidelines promote transparent communication between courts, permitting courts of different jurisdictions to communicate with one another and their respective insolvency

administrators. Courts are encouraged to adapt the Guidelines over time to suit the circumstances of each cross-border restructuring and reflect the international insolvency community's growing experience.¹⁵

Because the Guidelines focus on the mechanics of cross-border restructuring, US and Canadian courts have also developed protocols. Clearly, protocols are effective only when each court involved in restructuring proceedings has embraced them.

The protocols which the US Bankruptcy and Canadian Courts used in the *Mosaic*,¹⁶ *Archibald Candy*¹⁷ and *PSINet Ltd.*¹⁸ restructuring proceedings were instrumental to the success of cross-border sales in each of the proceedings. While the specific protocols were tailored to each matter, the three proceedings shared many common provisions. One key element was the understanding that adopting the protocol would in no way diminish each court's independence and jurisdiction over its own proceedings, critical to preserving the integrity of each country's restructuring process and promoting co-operation and respect for comity. Generally, cross-border protocols also grant the major participants standing in the other country's proceedings and courts to hold joint-hearings. For instance, the *PSINet* restructuring required joint hearings to approve sale of the Canadian assets through the stalking-horse bid process and to distribute proceeds from the sale of the Canadian assets.

Recent Influences on Canadian Restructurings

(a) Stalking-Horse Bidding Process

Almost skeletal, the *CCAA* briefly provides a legislative framework for corporate debtors to restructure their affairs with flexibility and creativity and create solutions tailored to their individual situations. Inherent flexibility makes the *CCAA* attractive to multinational debtors with significant Canadian interests and makes introducing to Canadian restructuring proceedings new concepts, such as the stalking-horse bidding process, fairly easy. Several recent cross-border restructuring proceedings have included successful stalking-horse bidding processes that maximized realizations for both US and Canadian stakeholders.¹⁹

In a stalking-horse bidding process, a potential purchaser enters into an agreement with the debtor (the "Purchase Agreement"), establishing a floor price against which later competing bids are compared. The Purchase Agreement generally includes a break-up fee for the stalking-horse bidder if a higher bid ultimately is accepted. The process is designed to obtain the best possible price for the corporation's property and assets, usually through an auction. Stalking-horse bidding

involving cross-border debtors generally includes the following steps: (i) the debtor finds a stalking-horse bidder; (ii) courts in both jurisdictions approve the Purchase Agreement and the bidding process terms; (iii) an auction is held; and (iv) both courts approve the final sale agreement with the successful bidder.

While section 363 of the *US Bankruptcy Code* imposes clear deadlines for notice, bidding and auctioning, neither the *CCAA* nor the *BIA* provides guidelines for stalking-horse auctions in Canada. However, the *CCAA*'s flexibility allows Canadian courts to exercise their inherent jurisdiction to approve stalking-horse bidding. The few cases where Canadian courts have approved stalking-horse bidding demonstrate that Canadian courts will sanction a sale process that maximizes the debtor's value for creditors and stakeholders and conforms to Canadian standards of procedural fairness for selling insolvent companies' assets. To ensure certainty, parties are wise to involve Canadian courts early in the process.

When considering whether to approve a stalking-horse process, Canadian courts are mainly concerned with procedural fairness. In *Royal Bank of Canada v. Soundair Corporation*,²⁰ the Ontario Court of Appeal established principles to guide Canadian courts in approving any sale of a debtor's assets in insolvency proceedings; Canadian courts also apply these principles when considering proposed stalking-horse bids.²¹ Courts consider whether the debtor has made sufficient effort to secure the best price and has not acted improvidently and whether the stakeholders' interests (primarily creditors) have been addressed. Courts also consider the process' overall efficiency, integrity and fairness. Although courts should not second guess every decision in the sale process, they must ensure a generally fair process.

(i) An Early Success – *PSINet Ltd.*

PSINet and its related companies obtained Canadian recognition of their *Chapter 11* filing and a concurrent stay of proceedings for the Canadian subsidiaries under s. 18.6 of the *CCAA*. A stalking-horse sale process was developed for *PSINet*'s Canadian assets, some of which US debtors owned. Although unprecedented for Canadian restructuring proceedings at the time, the Canadian court approved the process with Telus Corporation ("Telus") as the stalking-horse bidder. In granting the order, Justice Farley noted that the *Soundair*²² principles would apply to the auction and the ultimate sale. In the end, no additional bids were received and no auction was held. At a US/Canadian joint hearing approving the sale to Telus, the Canadian court examined the stalking-horse process in light of the *Soundair* principles.

Key factors contributing to the PSINet sale's success were the Canadian court's early involvement in the restructuring and the use of a formal court-approved cross-border protocol to facilitate co-operation between courts.²³

(ii) Recoton and Delano – Perils of Proceeding Without Prior Canadian Court Approval

The success of the PSINet restructuring and the Canadian court's adoption of the stalking-horse process encouraged US restructuring professionals to seek Canadian court approval of sale processes developed, approved and implemented in US restructuring proceedings without the early involvement of the Canadian courts. Consequently, Canadian courts have now made it clear that they will not simply "rubber-stamp" US sale processes. For instance, in *Heller Financial Inc. v. Recoton Canada Ltd.*,²⁴ the Canadian court did approve a stalking-horse sale from the US, but expressly disapproved of the fact that Canadian court approval was sought only after the US sale was a *fait accompli*.

Similarly, in *Delano Technology Corporation*,²⁵ the Canadian court was asked at the 11th hour and without proper notice to Canadian creditors to approve a stalking-horse auction process that had been developed and approved in a US restructuring proceeding. Although it approved the stalking horse auction to avoid duplicating proceedings, the Canadian court criticized the process and required extensive advertising and notice to Canadian creditors before recognizing and approving the sale.²⁶

If the Canadian court had found that the sale process had prejudiced Canadian debtors or creditors, the courts in these cases probably would have refused to approve the sale, thus jeopardizing the primary debtor's restructuring and potentially harming all stakeholders.

(iii) Recent Cases – Lesson Learned

In most cases, Canadian courts do not automatically approve sales processes developed, approved and implemented in *Chapter 11* proceedings; rather, they exercise their discretion as evidenced in the restructuring of Archibald Candy and its Canadian subsidiary, Archibald Candy (Canada) Corporation ("Archibald Canada"). Archibald Candy filed for protection under *Chapter 11* and obtained an order under s. 18.6 of the *CCAA* recognizing the *Chapter 11* stay. To sell the Laura Secord business in Canada, components of which were owned by the US and Canadian debtors, the debtors applied to the Canadian court for the appointment of an interim receiver pursuant to s. 47.1 of the *BIA*. Before the interim receiver was appointed, Archibald Candy had initiated an extensive marketing process

in the US.

The Canadian Court appointed the interim receiver to review the US marketing process and bidding procedures regarding the Laura Secord business, its fairness and transparency. The Canadian Court approved the stalking-horse bidding process on the basis of the interim receiver's report that the marketing process and the bidding procedures were fairly designed to achieve the highest possible realization and the break-up fee was neither excessive nor likely to discourage third parties from making competing bids.²⁷ At a joint hearing, the US and Canadian courts authorized Archibald Canada to enter into the Purchase Agreement and approved the bidding procedures and break-up fee. Additional rounds of bidding were conducted at the auction and Gordon Brothers Group, LLC, was selected as purchaser, with a bid 30 percent higher than the stalking horse bid.²⁸

Early Canadian court involvement was also instrumental in the successful stalking-horse bidding process in the cross-border restructuring of Mosaic. In *Mosaic*, both the Canadian and US Bankruptcy Courts approved a cross-border protocol and a stalking-horse bidding process was conducted with particular focus on fairness, as enunciated by the Canadian court. An independent bidding process was used to select the stalking-horse bidder and ultimate purchaser. The use of a preliminary bidding process ensured that the stalking-horse bidder was selected in a competitive way that satisfied the Canadian court's concerns regarding the sale process' fairness. Both courts approved the auction process and the sale.²⁹

(b) Creditors' Committees

While unsecured creditors' committees ("UCC") are a fixture in American restructuring proceedings by virtue of section 1102 (a)(1) of the *US Bankruptcy Code*, no corresponding provisions require creditors' committees under the *CCAA* or *BIA* and UCCs are rarely formally organized in Canadian restructuring proceedings. However, the *CCAA* does require courts to appoint a monitor, an officer of the court, to report on the status of the debtor's restructuring. No comparable provision of the *US Bankruptcy Code* requires appointment of a monitor or similar position. A leading Canadian insolvency judge has observed that, in the absence of an independent monitor, UCCs may be needed in US restructuring proceedings so as to protect unsecured creditors' interests.²⁸ Although most practitioners would agree that formal UCCs need not be appointed in Canadian restructuring proceedings, given the conflicting roles assigned to the monitor, stakeholders' interests in a restructuring are best represented by *ad hoc* creditors' committees.

The expanding influence of US *Chapter 11* proceedings over Canadian restructuring proceedings is apparent from the increased use of creditors' committees in Canadian restructuring proceedings. In Canada, *ad hoc* committees of creditors are most often organized independently of the court process, but generally have standing to appear in court as a recognized stakeholder. Creditors' committees play a markedly different role in Canadian proceedings. In Canadian restructuring proceedings that do use formally-organized and court-approved committees, the committees generally represent the unsecured creditors in negotiating a plan of arrangement or other restructuring solution with the debtor company.

During the restructuring proceedings of Canada's largest airline carrier, Air Canada, an *ad hoc* unsecured creditors' committee representing 12 major industrial and financial corporations including Air Canada's bondholders, banks, lessors and trade creditors, worked with Air Canada to formulate various restructuring proposals so as to maximize the unsecured creditors' recoveries through ongoing negotiations on Air Canada's restructuring and related material transactions.³¹ The Statement of Organizing Principles of the creditors' committee provided that the committee had no legal authority to represent the unsecured creditors generally nor to legally bind

its members. Air Canada was to fund the committee as part of its restructuring costs.

Despite its restricted authority, the creditors' committee played an important role in Air Canada's restructuring. For example, the bids for an equity investment were reviewed by the committee's financial advisor, who provided input for the ultimate choice of an equity investor for Air Canada.³² The UCC's significance in Air Canada's restructuring was demonstrated by a motion brought by a committee of senior financial creditors seeking voting-member status on the UCC.³³

Conclusion

Recent Canadian/US restructuring proceedings confirm Canadian courts' willingness to cooperate with the US Bankruptcy Courts to facilitate integrated cross-border restructuring proceedings and adopt restructuring mechanisms that are not inherent to the Canadian restructuring process as long as the independence and integrity of the Canadian restructuring process are respected. Recent successful cross-border restructurings strongly suggest a trend toward co-operation and mutual respect for each country's procedural and substantive restructuring regimes for the sake of maximizing outcomes for all concerned stakeholders.

¹ R.S.C. 1985, c. C-36.

² R.S.C. 1985, c. B-3.

³ *Supra* note 1, s. 18.6(1).

⁴ (2000), 18 C.B.R. (4th) 157.

⁵ *Ibid.*, at 167-168.

⁶ *Supra* note 2, s. 268(1).

⁷ *Ibid.*, s. 268(3).

⁸ *Ibid.*, s. 269.

⁹ 11 U.S.C. § 101(23).

¹⁰ *Re Air Canada*, Court File No. 03-CL-4932.

¹¹ *Stelco Inc. et. al.*, Court File No. 04-CL-5306.

¹² *Re Fantom Technologies Inc. et. al.*, Court File No. 01-CL-4303 (Ont. S.C.J.), US Case No. 01 16783-K.

¹³ J.B. Gollob and S. J. Donaher, "Co-ordinating Cross-Border Insolvencies." [unpublished], at 18-19.

¹⁴ "Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases," The American Law Institute, Judicial Preface, April 2004, at ix.

¹⁵ *Ibid.*, Introduction at 1-2.

¹⁶ *Re Mosaic Group Inc.*, Court File No. 02-CL-4816.

¹⁷ *Re Archibald Candy Corp. et. al.*, Court File Nos. 04-CL-5308, 04-CL-5461.

¹⁸ *PSINet Ltd. et. al.*, Court File No. 01-CL-4155.

¹⁹ The most current example is in the restructuring of one of Canada's largest steel companies, Stelco Inc., in which Deutsche Bank has been selected as the stalking-horse.

²⁰ (1991), 7 C.B.R. (3d) 1.

²¹ *Re PSINet Ltd.* (2001), 28 C.B.R. (4th) 95.

²² D.F.W. Cohen and D.S. Kolesar, "Canadian Perspective on Chapter 11 Stalking Horse Bid Process", (2004) 21 *National Insolvency Review* 25 at 31.

²³ *Supra* note 18.

²⁴ Court File No. 03-CL-5005.

²⁵ Court File No. 03-CL-4962.

²⁶ F.L. Meyers et. al., "U.S.-Canada Insolvency Proceedings" (2003) *Commercial Litigation* 502, at 503.

²⁷ *Supra* note 17.

²⁸ *Ibid.*

²⁹ *Supra* note 22 at 32.

³⁰ *Supra* note 10 (Endorsement of The Honourable Mr. Justice Farley dated August 7, 2003).

³¹ Air Canada News Release (18 May 2003).

³² *Supra*, note 10 at paras. 12-13.

³³ *Ibid.*, (Endorsement of The Honourable Mr. Justice Farley dated August 7, 2003).



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