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Flexibility and creativity: hallmarks of Canada's restructuring framework

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If 'necessity is the mother of invention'[2], then insolvency is a perfect incubator within which creative solutions can emerge. Fortunately for companies that conduct business in Canada, the restructuring options that exist are broad, flexible and respond to even the most unusual of circumstances.

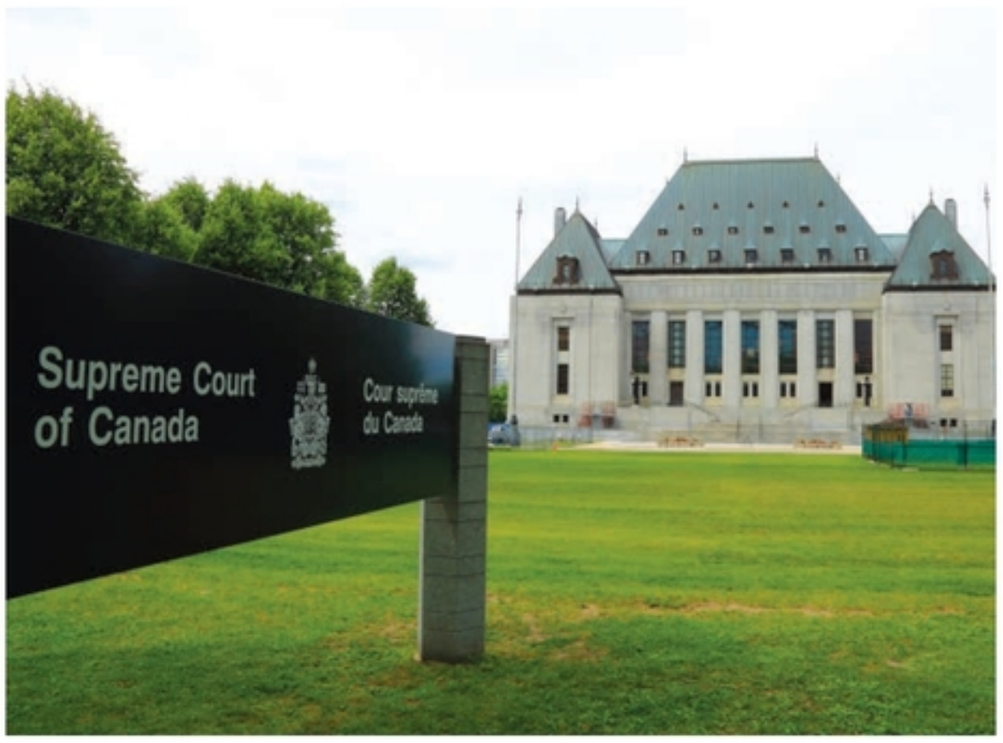
Canada's main restructuring statute is relatively bare-bones in nature and is not encumbered by extensive restrictions on what steps may be taken, rigid timeframes as to when they must be taken, or limited circumstances in which particular relief may be available.[3] The statutory framework is also supported by a well-developed body of jurisprudence which reflects the willingness of Canadian judges to be responsive to the "real-time" nature of insolvency proceedings and to grant appropriate relief that fits the unique facts of a particular case. As such, Canada provides a model of efficiency, flexibility and creativity for restructuring solutions.

The two main federal statutes under which debtor companies can seek to restructure in Canada are the *Bankruptcy and Insolvency Act* (Canada) (the 'BIA')[4] and the *Companies' Creditors Arrangement Act* (the 'CCAA').[5] Generally, the BIA is utilised by a debtor company: (i) when bankruptcy, as opposed to a restructuring, is appropriate; or (ii) to present a 'proposal' to creditors that is less complicated or will require less judicial oversight than a full restructuring under the CCAA. For more complex restructurings involving companies with collective agreements, defined benefit pension plans or cross-border aspects, a proceeding under the CCAA will generally be the chosen path forward.

Until it was amended in 2009, the CCAA had only 22 sections in total.[6] Notwithstanding its brevity, this statute has provided the basis for the largest and most complex restructurings in Canada including those involving Air Canada, Stelco, Abitibi-Bowater, Olympia & York, Nortel Networks, US Steel Canada and many others. One of the most important, and unique, aspects of the CCAA is the following provision:

> ***General power of court***
> 11 Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act,* if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

Since broad judicial discretion is conferred under the CCAA, it is perhaps not surprising that decisions issued by Canadian judges in restructuring proceedings reflect practical, flexible and creative solutions to some of the most difficult issues that arise. That has proven to be the case even where the CCAA appears to be otherwise unavailable to a particular debtor



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company, where other more traditional avenues for resolution have proven futile, or where the facts cry out for a solution and none is readily apparent.

One such example can be found in the case involving Castor Holdings Ltd.[7] A national accounting firm in Canada had been embroiled in auditor's negligence litigation spanning 22 years, described by one of the presiding judges as "the longest running judicial saga" in Canada. It involved more than 40 plaintiffs (including foreign and domestic financial institutions, insurers and other stakeholders), several associated or successor firms and approximately 400 accounting and other individual professionals across the country.

Restructuring advisors were retained by the defendant partners of the national accounting firm after two decades of entrenched litigation among the parties.[8] A creative solution was developed to address and resolve all claims through a CCAA proceeding. The proposal involved numerous procedural and substantive hurdles. For example, the threshold requirement for a debtor commencing a CCAA proceeding and obtaining the benefit of a stay of proceedings did not extend to professional firms such as the accounting firm in question.[9] A unique 'synthetic bankruptcy' mechanism was developed to satisfy stakeholder and plaintiff concerns over the problematic questions of adequate disclosure of assets to satisfy any judgment, and appropriate funding issues on the part of the former partners of the professional firm. After intense negotiations, a 'coalition of the willing' creditors was achieved to support a structured settlement among a small, but influential group of plaintiffs. Through combined litigation and negotiation tactics, the defendants garnered enough support to pass a Plan of Arrangement to resolve all claims. Creativity within the CCAA framework, together with the flexibility shown by the Canadian judge, facilitated an efficient resolution to one of the most intractable cases in Canadian litigation history.

Another case in which the flexibility of Canada's restructuring framework was tested involved a catastrophic loss of life arising from a tragic railway accident that resulted in significant financial losses to the affected company. In July 2013, a freight train derailed in the village of Lac-Mégantic, in the Province of Quebec. Forty-seven people were killed, and the downtown area was effectively destroyed. In the wake of the disaster, numerous claims were filed against the railway company, Montréal, Maine & Atlantique Canada Co. ('MMA'). MMA filed for court protection under the CCAA in August 2013 in order to obtain a stay of proceedings and provide a comprehensive and binding forum for resolving claims filed against it. A threshold issue to be determined was whether MMA was a 'company' within the meaning of the CCAA, such that it could qualify as a 'debtor company' entitled to seek protection.[10] Section 2 of the CCAA contains a definition of 'company' which specifically states that the term "does not include … railway or telegraph companies." Similarly, the BIA defines "corporation" to not include railway companies.[11]

Nonetheless, the Court granted the initial Order which commenced the CCAA proceeding, allowing the company to develop a Plan of Arrangement which had the effect of compromising all claims against it. The Court found that the very limited insolvency provisions in the *Canada Transportation Act*[12] left a 'legal vacuum'.[13] As a result, it chose to exercise its inherent jurisdiction under section 11 (reproduced above) to grant an initial Order and a stay of proceedings. The Court justified this by focusing on the interests of MMA's creditors, saying that to "deny MMA the right to avail itself of the [CCAA] would be grossly unfair with respect to the rights of ordinary creditors – including the victims in Lac-Mégantic – and absolutely unacceptable in a society governed by the rule of law."[14] The Court also noted the risk that applying different statutes to different creditors could create inconsistencies and injustices.[15] In other words, substance will prevail over form when the facts demand a practical, timely and equitable solution.

A very recent further example of the Canadian Court's flexibility in granting relief that responds to unique fact situations involves a cross-border insolvency proceeding that is currently pending before the Canadian and US Courts.[16] As the proceedings will not be completed for another several weeks at the time of writing, we will refer to the debtor companies as simply the 'Cubed Companies'. The Cubed Companies comprise a group of companies incorporated and doing business in both Canada and the US. Chapter 11 proceedings were commenced under the US Bankruptcy Code for all companies, on the basis that the US was the centre of main interests for the group. Proceedings were then brought in Canada pursuant to the CCAA for recognition of the Chapter 11 proceedings including Orders granted by the US Court.

This restructuring involved a pre-packaged joint Plan of Arrangement and was therefore subject to a two-week solicitation period prior to the Chapter 11 petitions being filed in the US. If news of the impending bankruptcy filing became public prior to the intended petition date, the filing date in the US could have been moved up in order to obtain the automatic stay of proceedings under the US Bankruptcy Code. However, that created a potential problem on the Canadian side of the cross-border proceeding. The CCAA does not provide for an automatic stay of proceedings upon filing, but rather, a stay is only available pursuant to court Order. The Canadian proceedings were for recognition of the foreign main proceedings brought in the US, and accordingly, recognition could not be sought in Canada until the first-day orders had been issued by a US Court. A potential gap could therefore arise where a stakeholder could terminate rights or take certain

steps in Canada, before an Order recognising the US foreign main proceedings could be obtained.

Due to the nature of the Cubed Companies' business, it depended upon licenses issued by a regulatory authority in each of the Provinces and Territories in Canada, supported by financial bonds posted in each Province. Any suspension or termination of the licenses or the bonds that supported the licenses, even on a temporary basis, could seriously harm the business and jeopardise the ability to complete the pre-packaged transaction. Provided the businesses were permitted to operate in the ordinary course to facilitate the intended transaction upon filing, creditors in Canada would be unaffected by the pre-packaged joint Plan of Arrangement and would continue to be paid in the ordinary course.

Faced with different statutory requirements in Canada and the US, and the need to preserve stability to permit a future (intended) insolvency proceeding to be commenced, the Canadian Court was satisfied that the provisions of the CCAA permitted extraordinary relief to be granted, based on the particular facts of the case. As a result, the Court granted an immediate and unprecedented pre-filing stay of proceedings – prior to the commencement of any insolvency proceedings in Canada or the filing of the Chapter 11 petitions in the US. If any stakeholder had taken steps in the two weeks prior to the commencement of the insolvency proceeding which affected the ability of the Cubed Companies to carry on their business, the signed and issued Order could be given to them.[17] The effect of the Order was to require compliance with an interim stay of proceedings and the preservation/reinstatement of rights, from the day on which it was issued (which coincided with the commencement of the solicitation period of the pre-packaged Plan of Arrangement).

The Order was obtained without notice to any party (as to give notice would defeat the very purpose of it) with the original signed Order maintained under seal at the court office until the subsequent commencement of the Chapter 11 proceedings and CCAA recognition proceedings. Counsel for the Cubed Companies had the only other signed copy of the Order. The Canadian Court responded favourably to a creative use of various provisions of the CCAA coupled with applicable procedural rules of the Court, by showing flexibility and a willingness to facilitate solutions that met the unique requirements of the case.

Given the above examples, a reader should not be left with the impression that creativity and flexibility in the Canadian restructuring framework have resulted in the core principle of commercial certainty being compromised or undermined. On the contrary, capital markets in Canada are robust and continue to attract sophisticated participants who thrive in an environment where creative solutions are encouraged and rewarded. This has the benefit of causing stakeholders and their advisors to constantly strive to find better solutions for the most difficult business problems.

Footnotes:

1 D.J. Miller is a partner in the insolvency and litigation firm Thornton Grout Finnigan LLP located in Toronto, Canada. TGF has represented a variety of stakeholders in the largest restructuring proceedings in Canada for more than 20 years.
2 *Republic*, by Plato.
3 When compared, for example, with the extensive provisions of chapter 11 of title 11 of the United States Code ['US Bankruptcy Code'].
4 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.
5 R.S.C. 1985, c. C-36 ['CCAA'] Proceedings can also be commenced under the federal *Winding Up and Restructuring Act*, R.S.C. 1985, c. W-11. However, it is generally used in very limited circumstances, when dealing with particular entities such as banks, trust companies and insurance companies.
6 Even after the extensive 2009 amendments the CCAA remains brief, with only 63 sections in total.
7 *4519922 Canada Inc. Re*, 2015 ONSC 124 (Ont. S.C.J. [Commercial List]).
8 The author's firm was retained by the partners of the national accounting firm, and commenced the CCAA filing as a means to finally resolve these claims.
9 The Court was satisfied that, as one company existed within the affected group, the applicants could qualify as a 'debtor company' within the meaning of the CCAA.
10 *Montréal, Maine & Atlantique Canada Co., Re*, 2013 QCCS 4039 ['*Re MMA*']
11 R.S.C. 1985 c. B-3, s 2
12 S.C. 1996, c. 10, which governs insolvent railway companies at sections 106 to 110.
13 *Re MMA*, para. 18
14 *Ibid*, para. 24
15 *Ibid*, para. 25
16 The author acts as Canadian counsel for the 'Cubed Companies' and obtained the Order referenced above.
17 As no creditors took steps to enforce their rights during the two week pre-filing period, the Order did not have to be enforced. It therefore served as a form of insurance policy that was never utilised.

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