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Restructuring of Insolvent Corporations: Creditor Rights and Judicial Recognition of the "Public Interest", Principles for Reconciliation

by

Janis Pearl Sarra

A thesis submitted in conformity with the requirements for the degree of Doctor of Juridical Science
Graduate Department of the Faculty of Law
University of Toronto

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RESTRICTURING OF INSOLVENT CORPORATIONS: CREDITOR RIGHTS AND JUDICIAL RECOGNITION OF THE "PUBLIC INTEREST", PRINCIPLES FOR RECONCILIATION

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Janis Pearl Sarra

Doctor of Juridical Science, 1999
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Abstract

Canadian insolvency law has historically been viewed as a secured creditor-friendly regime. Yet legislative debates and judicial interpretation have suggested that in determining the future of the insolvent corporation, there is an element of "public interest" in the outcome of restructuring proceedings. This "public interest" is rarely defined. The parties traditionally before the courts, the debtor corporation and secured creditors, have frequently relied on notions of public interest to advance their particular position. Yet the individuals and groups that arguably comprise part of that public interest, trade suppliers, workers, local governments and contingent creditors have historically not been active in the restructuring process. In the past several years these groups have begun to participate, necessitating a more comprehensive approach to reconciling diverse interests. Recent caselaw indicates that "public interest" is a "short form" for the complex balancing of interests that the court engages in when determining whether to sanction a plan of arrangement or compromise for the insolvent corporation. This "short form" must be unpacked and better defined in order for all parties to understand the factors that are relevant to the court's use of the "public interest" in its balancing with the interests of traditional creditors and the debtor corporation.

The investments of non-traditional creditors such as workers, local governments and trade suppliers are interests beyond fixed capital claims. Their investments are often of a reliance or equitable nature. Moreover, these stakeholders have an interest in the future of the corporation that is not fully recognized in the structure of value and voting in the current scheme. Such non-traditional creditors may be uniquely situated to contribute informational and organizational capital in the negotiations for a viable business plan in a workout under restructuring proceedings. These investments also give rise to fiduciary obligation by directors and officers of the insolvent corporation. A central challenge of insolvency law is to accord these stakeholders participation and decision rights in a manner that recognizes their human capital and other investments, generates surplus value for the firm, and yet simultaneously controls transaction costs. The current regime is well situated to adopt a more textured approach to restructuring and recent caselaw suggests that the court in some instances has successfully recognized and accorded value to these diverse interests. However, changes to recognize equitable investments must ensure that these interests are properly balanced against those of secured lenders and other traditional creditors. The Companies' Creditors Arrangement Act is the key legislative vehicle through which reconciliation of such rights can occur, accompanied by a facilitative and supervisory role by the court, including clearer direction to its officers regarding participation and decision rights for all stakeholders with an interest in the insolvent corporation.

A comparison amongst international insolvency regimes illustrates that while debt collection and rehabilitation regimes are not closely converging in their approach, they have nevertheless recognized a policy objective of more effective balancing of interests in reorganization proceedings in order to prevent premature or deferred liquidation. However, some of the regimes suffer from prolonged proceedings, excessive transaction costs, failure to adequately balance interests, and inadequate governance controls. Canadian insolvency law offers the optimal model for addressing many of these problems. It has not been fully recognized for its contribution to international insolvency law.
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Any errors are of course my own.
Restructuring of Insolvent Corporations: Creditor Rights and Judicial Recognition of the “Public Interest”, Principles for Reconciliation

Janis Sarra

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INTRODUCTION

Canadian private law has created what scholars and insolvency lawyers describe as a "secured creditor-friendly" regime for the enforcement of claims and liquidation and distribution of assets of the insolvent or bankrupt corporation. This creditor directed process is tempered somewhat by a statutory scheme that allows corporations in some cases to restructure their affairs to try to become solvent. These restructuring mechanisms, which afford the debtor corporation an opportunity to make arrangements or compromises with creditors, have created a regime that attempts to balance shareholder and creditor interests. Legislative debates and recent caselaw have suggested that there is an element of the "public interest" in the outcome of restructuring proceedings. This "public interest" is rarely defined and the parties traditionally before the courts, the debtor corporation and secured creditors, have frequently relied on notions of public interest to advance their particular position. Yet the individuals and groups that arguably comprise part of that public interest, trade suppliers, workers, local governments and others, have historically not been active in the restructuring process. The recent participation of these groups necessitates an unpacking and better definition of "public

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1 George Triantis defines restructuring as the legal process in which insolvent firms are made solvent by an exchange of existing debt claims and equity interests for packages of capital, new claims and interests. The restructuring plan provides the terms of exchange and distributes the value of the firm to its claimants. G.G. Triantis, "The Interplay Between Liquidation and Reorganization in Bankruptcy: The Role of Screens, Gatekeepers and Guillotines" (1996) 16 International Review of Law and Economics 101 at 101.
interest” in order for all parties to understand the factors that the court will consider in balancing the diverse interests in restructuring proceedings.

My thesis is that the court’s more express recognition of the “public interest” in corporate workouts is a positive development in the caselaw, one that should be encouraged by all of the involved constituent groups, but one that deserves more careful definition. The purpose of the statutory provisions is to allow corporations to propose workouts which involve viable business plans that are acceptable to creditors. I argue that there is a continuum of interests for various stakeholders in the successful turn around of a firm and that the interests of those stakeholders ought to be expressly recognized and accorded a role in the process. Just as for solvent corporations, the central corporate governance issue in insolvency restructuring is how to allocate risks and benefits, decision and control rights. These allocations must recognize who has investments at risk in the corporation, the priority amongst their interests, and who has the incentive to develop a business and restructuring plan that will create efficiencies and added value for the corporation. I set out the rationale for such a view and the means by which this could be accomplished. I then measure the existing regime against these ideas, highlighting some of the limitations of the current regime.

It is important to note at the outset that the scope of this thesis is limited to restructuring of insolvent corporations. In this respect, I am applying a broader set of principles to a defined area of the law. These principles, which involve the recognition and valuing of human capital and other equitable investments, have application to other areas of corporate law such as mergers, hostile takeovers or restructuring of financially healthy corporations. Application of the framework to these corporate activities is appropriately the subject of future research.

With the globalization of capital and labour markets, the highly leveraged financial structuring of firms, technological change, increased environmental liability, and other
developments of the past two decades, corporations have increasingly faced serious financial problems, often leading to insolvency.\(^2\) Canadian law has sought to provide remedial protection to corporations in terms of affording them the protection of the court while the company attempts to reorganize itself to become viable once again.\(^3\)

These processes raise a number of important questions regarding who is governing the corporation at the point at which it is insolvent and under negotiations for a "workout".\(^4\) Often, at the point of insolvency, shareholders have little if any equity remaining in the corporation. Directors, particularly those without substantial equity investment, are often encouraged by their counsel to resign to limit any additional liability. Managers are often replaced early in the process because of a perception that they are responsible for the economic situation of the corporation. Where there is a court-appointed receiver or trustee, governance falls to those officials, and yet their priorities may differ in terms of having an interest in the long-term viability of the corporation. Of vital importance, therefore, is who is making decisions in the best interests of the corporation at the point of insolvency. More fundamentally, what is in the best interests of the insolvent corporation in a scheme that currently seeks to maximize value for creditors, primarily secured creditors. How are those interests reconciled with the interests of other stakeholders, and how is a balancing of interests to occur in a manner that will allow potentially viable firms to survive and yet will prevent perpetuation of inefficient

\(^2\) "Insolvency" is generally defined as being unable to meet liabilities as they generally become due, but the company has not been put into bankruptcy and there are no legal consequences that flow from being insolvent. "Bankruptcy" is the result of a legal procedure whereby a person or entity is put into bankruptcy and legal consequences flow from that, including liquidation of the debtor’s property. Jacob S. Ziegel, Benjamin Geva, and R.C.C. Cuming, Secured Transactions in Personal Property, Suretyships and Insolvency, Volume III, Commercial and Consumer Transactions, Cases, Text and Materials, 3rd ed. (Toronto: Emond Montgomery Publications Ltd., 1995) at 503, 521.

\(^3\) Geoffrey Morawetz, "Emerging Trends in CCAA Restructurings" (Toronto: The Insolvency Institute of Canada, 1990) at 35.

\(^4\) Workouts are defined generally to mean that the corporation is trying to work out its affairs in a manner acceptable to creditors, through restructuring of debt, compromise of debt, conversion of debt to equity and other arrangements that allow the corporation to continue operating. Workouts can be private or court supervised, but are generally viewed as arrangements made with creditors at the point that the corporation is approaching or has become insolvent. This is distinguishable from forms of restructuring of solvent corporations.
corporations? Finally, what processes are available at law to ensure effective
governance?

The focus here is the governance issues raised during the court-supervised restructuring
process. In Canada, there are four principal means by which insolvent corporations can
restructure or reorganize their affairs. The first is through private workouts, in which the
debtor corporation makes arrangements with its creditors in order to continue operating.
The other three means involve court-supervised processes and include the approval of
proposals under the Bankruptcy and Insolvency Act (BIA), the approval of plans of
arrangement or compromise under the Companies’ Creditors Arrangements Act (CCAA),
and plans of arrangement under corporations statutes. While the principal focus here is
on the CCAA, the issues raised and addressed are relevant to all of these procedures.

The CCAA is a key statutory vehicle through which restructuring occurs. The CCAA was
enacted during the depression years when a then unprecedented number of companies
faced insolvency and governments were worried about the long-term economic
consequences of firm failure. In reality, it was a little used statute at the time, as most
corporations were to enter a prolonged period of economic prosperity in which their
viability was not at issue. As a result, the statute essentially fell into disuse for almost
fifty years. In the past decade, it has enjoyed a remarkable revitalization and is now
routinely used by debtor corporations as the statutory mechanism for court approved
restructuring. Ziegel and Baird have attributed this to the severe recession suffered in the
late 1980’s and 1990’s in all sectors of the Canadian economy due to globalization and

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the other trends mentioned above. The emergence of the CCAA as an important commercial tool has led to a proliferation of cases in which the courts have given direction on: definition of classes of creditors for purposes of voting on proposed plans; rights of various parties to participate in the restructuring process; and the statutory standards to be met for sanctioning of plans of arrangement or compromise. The cases have been accompanied by an increase in thoughtful scholarly commentary on the CCAA as an effective public law tool to assist private parties in their workouts.

One area that has received little scholarly attention is the issue of what rights or role should be accorded in the CCAA process to non-traditional creditors or stakeholders, i.e. stakeholders other than traditional commercial creditors or shareholders. These stakeholders include workers, local governments, consumers and others who may have an interest in the corporation. The courts in the past decade have referred to the “public interest” without really defining the nature of that interest and its role in the governance and restructuring of insolvent corporations. Should a process that seeks to balance the interests of debtors and creditors recognize the investments of workers and communities in the viability of the corporation? Should the existence of contingent creditors in the form of tort claims be recognized not only as a class of creditors but also as parties with an interest in the restructuring of the corporation?

Examination of these questions is particularly relevant at this juncture in the history of Canadian insolvency law for two reasons. First, the courts have very recently accorded a greater role to workers, their unions, and other stakeholders, by express recognition of

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6 For example, 25 of the 27 leading case studies in Ziegel and Baird’s book are restructuring cases that have occurred in the past decade. Jacob Ziegel and David Baird, eds. Case Studies in Recent Canadian Insolvency Reorganizations, In Honour of the Honourable Lloyd W. Houlden (Toronto: Carswell, 1997) at xxxiii. In addition, there are currently approximately ten major CCAA cases before the Ontario Superior Court of Justice alone in 1999.

7 See for example, Morawetz, supra, note 3; Triantis, supra, note 1; Ziegel and Baird, supra, note 6; Jacob Ziegel, “Canadian Bankruptcy Reform, Bill C-109 and Troubling Asymmetries” (1996) C. B. L. J. 108; L. W. Houlden and G. B. Morawetz, eds., The 1999 Annotated Bankruptcy and Insolvency Act (Toronto: Carswell, 1998).
“social stakeholders” and the “public interest” in restructuring proceedings. While, as I discuss in chapters 2 and 3, this is an important move forward by the courts, the concept of public interest and the role of non-traditional creditors need some further development.

Second, this discussion is particularly timely because of the increasing prevalence and serious consequences of economic failure of Canadian corporations. The past two decades have witnessed unprecedented mergers and acquisitions, trade liberalization and consequent intensified product market pressure and erosion of market share. Firm failure has resulted in part from the inability of firms to quickly adapt to deregulation, technological, product and organizational innovation change, and decreasing demand for domestic low skilled labour with the increasing availability of low cost labour elsewhere. These trends combined with increased environmental and tort liability and the consequences of the high leverage lending of the 1980’s, resulted in a number of firms becoming insolvent in the 1990’s.

Firm failure carries with it much broader consequences for creditors, shareholders, workers and communities than ever before. While accurate quantitative data do not exist, there is considerable empirical evidence to suggest that the magnitude of economic loss and the harmful nature of firm failure have created unprecedented social and economic consequences. The result has been that the CCAA and other statutes have become vitally important as tools for the restructuring and governance of insolvent corporations. Examples of cases in the past decade illustrate this point. The insolvency of Olympia and

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8 See the discussions of Anvil Range Mining Corporation, Skydome Corporation and Canadian Red Cross, Chapters 6 and 7, infra.


York Developments involved $13.5 billion dollars in debt and 29 related companies. Bramalea's insolvency involved debt of $4.8 billion and 2,250 employees. Northland Properties employed over 1,000 employees and had over $200 million in debt when it filed under the CCAA. The insolvency of Anvil Range Mining Corporation involved 25% of the Gross Domestic Product of the Yukon Territories. Cadillac Fairview's 1994 insolvency involved 1,600 employees and $8 billion in debt. Algoma Steel's CCAA case involved $750 million in debt and over 6,000 workers. Ball Canada employed 1,800 workers and had debts of over $30 million at the time it filed for court protection. The 1999 CCAA application of Royal Oak Mines involved $600 million in debt and almost 1,000 employees. White Rose's CCAA application involved 2,600 employees, 1,200 suppliers and over $78 million in debt.

Thus, while accurate quantitative data on the actual number of CCAA cases continues to be elusive, it is clear that these restructurings have a significant impact on Canada's economic health. This includes loss of economic activity, loss of jobs, loss of markets for local suppliers, increased adjustment costs in terms of unemployment benefits and

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13 Ralph McRae, "Northland Properties Ltd." in Ziegel and Baird, supra, note 6 at 101-2.

14 Anvil Range Mining Corporation, Application Motion, Ontario Court File No. 98-BK-00126.

15 Barry Goldberg, "Cadillac Fairview, A Vulture's Lean Cuisine" in Ziegel and Baird, supra, note 6 at 41.

16 James McCartney, "Algoma Steel Inc.: A Successful Restructuring" in Ziegel and Baird, supra, note 6, 235 at 251.

17 Dunphy, supra, note 10 at 255, 257.


welfare costs, and reduced tax bases for local and provincial governments.\textsuperscript{20} Moreover, firm failure has ripple effects. For example, one study showed that in 1992-94, 28% of all consumer bankruptcies occurred because of job loss or income reduction.\textsuperscript{21} The combination of the quantum of debt involved, the number of workers and communities affected, and the court’s recent recognition of interests beyond traditional creditors, makes this thesis extremely timely. Moreover, the recent participation of workers, local governments and non-traditional stakeholders as parties to the court-supervised restructuring process is a vitally important development in Canadian insolvency law, a development that I hope will be encouraged and facilitated by this discussion. Further consideration of precisely what interests are at stake and how the court should recognize those interests is required. Absent such analysis, the courts run the risk of more traditional debtor and creditor parties merely arguing that their particular position represents the “public interest”, leaving the court with little on which to base the balancing of interests to ensure that the objectives of the statutory scheme are met.

I argue that for corporations seeking protection under the \textit{CCAA} or other restructuring vehicles pending approval of a plan of arrangement, compromise or proposal, decision making should be undertaken in the best interests of the enterprise, having regard to all the interests and investments at stake. This is not to suggest that best interests might not ultimately be defined as a sale of the business or piecemeal liquidation of the assets of the corporation. However, in advance of such a determination, there ought to be express recognition of the interests at risk and a role for those interests in determining whether there can be an economically viable workout. I focus primarily on the \textit{CCAA} because it is in this context that the most significant cases in Canadian reorganizations currently occur.\textsuperscript{22} It is also this statutory process that affords both the court and the parties the

\textsuperscript{20} Wood, \textit{supra}, note 9 at 58-59. For example, in Ontario, the number of people on social assistance after exhausting employment insurance benefits quadrupled in the mid-1990s. \textit{Annual Reports, Social Assistance Review Board, 1993-1998} (Toronto: Queen’s Printer).

\textsuperscript{21} Vince Siciliano, “Trustee’s Role: From Petition to Discharge” (Canadian Bar Association Conference on Insolvency and Bankruptcy, Toronto, 1996) at 23.

\textsuperscript{22} The \textit{CCAA} applies only where claims against the debtor corporation exceed five million dollars. Section 3(1), \textit{CCAA, supra}, note 5.
greatest flexibility in recognizing the diverse interests of all those who have an interest in the viability of the corporation.

Those interests should be defined more broadly than solely the interests of traditional creditors and shareholders. While the courts and legal scholars have long recognized that best interests of the insolvent corporation differ from those of the solvent corporation by recognizing that creditors have the greatest interest in maximizing the value of the insolvent corporation, this definition of best interest needs to be refined. Creditors themselves represent diverse interests and comprise numerous types and quantum of claims. Yet to date, restructuring efforts under insolvency law have focused largely on secured creditors as decision-makers because of the nature, amount and priority of their claims. Notions of creditors’ interests need some unpacking, particularly where they intersect with a notion of the “public interest”. For example, I suggest in chapter 2 that workers’ investments in the corporation extend beyond their fixed wage and benefits claims. Similarly, local governments or communities have often made investments in the firm in terms of providing development funding, support systems, and assisting with the social and economic problems created as the result of insolvency. Arguably, local governments, whether or not traditional creditors in the sense of debt owed by the corporation for taxes or utilities, ought to have a role, should they wish, in the restructuring decision-making process.

Moreover, the current legal paradigm has narrowly cast the function of receivers and others as maximizing value for traditional creditors. I define traditional creditors as those creditors who have traditionally sought to enforce their claims through the debt collection mechanisms afforded by provincial and federal legislation and private debt instruments.23 They include banks, debenture holders, noteholders, mortgagees, and other secured and unsecured creditors. Historically, the caselaw regarding creditor wealth maximization

23 Laura Lin, “Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors’ Duty to Creditors” (1993) 46 Vanderbilt Law Review 1485 at 1486. This definition was originally proposed by Lin and is one that I endorse.
has had strong parallels to notions of maximizing shareholder wealth as the optimal goal of solvent corporations. Yet, absent actual bankruptcy and liquidation, there is a live issue as to whether this is the legal paradigm in which the courts actually operate or should operate. In Canada, the flexibility of the restructuring process under insolvency and corporations’ statutes, particularly under the CCAA, has meant that there has been incremental judicial development of notions of public interest and taking account of the interests of stakeholders other than shareholders and traditional creditors. These notions need further elaboration and clarification, with a view to assisting parties and the courts in governing their actions in the restructuring process.

The research methodology for this thesis represents a multi-faceted approach. Cases of court-supervised restructuring applications were studied, both the court files and the actual judgments rendered by the court. In this, I was assisted by an internship at the Ontario Superior Court of Justice, Commercial List during which the Court generously afforded me access to files, pre-hearing meetings and numerous hearings on CCAA cases over the course of 1998 and 1999. Scholarly commentary also provided a solid grounding for my analysis. I also interviewed more than forty insolvency counsel and other stakeholders that have been involved in court-supervised restructurings over the past few years. Although these interviews are too few to draw quantitative conclusions, they shed considerable light on some of the current strengths and weaknesses of Canada’s restructuring regime.

Chapter 1 briefly discusses the origins of Canadian restructuring law and suggests that the original purposes of the CCAA envisioned consideration of interests broader than those of shareholders and traditional creditors, but left the means by which this should be accomplished to judicial decision-making. The chapter then canvasses some of the current theoretical debate around creditor and shareholder interests in the insolvent corporation and the governance issues that are raised. Corporate governance has been defined as the legal and practical system for the exercise of power and control in the
operations of the corporation, including relationships among shareholders, directors and their committees, officers and other constituencies such as workers, suppliers, creditors, local communities and major customers. An understanding of the current debate regarding both the policy objectives and the policy instruments of insolvency and bankruptcy law is a necessary prerequisite to understanding the framework that I propose in the following chapter.

Chapter 2 then sets out the conceptual framework that I propose for the recognition of various stakeholder interests in the restructuring of insolvent corporations. My focus is on workers, communities and other "non-traditional" creditors such as tort claimants, although the analysis has relevance for more traditional creditors such as small trade suppliers. The interests of these stakeholders run along a continuum of fixed and residual claims, something that I have called equitable claims. Depending on the nature of the investment in the corporation, workers and other stakeholders should have the right to participate in negotiations and decisions in the development of a viable plan of compromise or arrangement when a firm fails. This role should be given substantive recognition, notwithstanding the fact that the capital claims of workers and other creditors are often very small compared to secured creditors' claims. Workers are uniquely situated in the corporation because of their human capital investments. Often with firm failure, there is untapped informational, organizational, and other human capital that can prove key to the development of a sound business plan. Arguably, there is also a range of other stakeholders such as local communities, who, in particular situations, have interests at risk in the corporation. While the nature of these claims may be more difficult to quantify, this should not act as a bar to their participation in the process if the


25 There has been considerable scholarly work undertaken on trade suppliers, particularly the question of whether there is the necessity for super-priority and the problems with enforcing unsecured debt. See for example J. Ziegel and K. Davis, “Protecting Vulnerable Creditors in Insolvency: Assessing the Economic Impacts of Granting Super-Priority to Unpaid Wage Earners and Suppliers of Goods and Services” (Faculty of Law, University of Toronto, 1998) [unpublished, cited with permission].
aim is to develop a restructuring plan that fairly allocates the risks and potential benefits of a financial turn around of the corporation's economic situation.

These equitable investments are often of both a reliance nature and an expectation interest. I suggest that they must be valued and quantified and suggest the means by which this can be accomplished. Once human capital and other equitable investments are assigned value, there are five outcomes. First, fiduciary obligation must be recast to require directors and officers to undertake decision making in the best interests of the corporation, having regard for all debt, equity and equitable investments. Second, the value of claims will afford workers and other non-traditional creditors access to participation and decision rights in the workout. Third, other stakeholders such as shareholders and traditional creditors would have a clearer understanding of the value of these claims in terms of the process to arrive at a viable business plan and acceptable plan of arrangement or compromise. Fourth, workers would be able to then agree to arrangements or compromises that protect their investment of human or other capital. Finally, in addition to satisfying these claims, the participation of workers and other equitable investors may enhance corporate decision making.

I suggest principles for the reconciliation of creditors' rights and judicial recognition of the "public interest" that are based on a clearer definition of the interests at stake and the priority accorded those interests under insolvency law. A focus solely on creditor wealth maximization or shareholder wealth maximization needs to be recast to an objective of enterprise value maximization with an accompanying recognition of fiduciary obligation to creditors and other stakeholders. Efficient and effective achievement of this objective necessitates that all of those with investments at risk in the firm have participation and decision rights in the restructuring process. Court-appointed officers have a key governance role to play in this respect.
In Chapter 3, I examine the current legal framework under which creditors and shareholders of insolvent corporations develop restructuring proposals or plans. The statutory scheme and judicial interpretation illustrate the contribution and limitations of the regime as evaluated against my proposed framework. This includes the issues raised by private versus court supervised restructuring, and how public interest concerns are or are not addressed through existing workout mechanisms. I conclude that the notion of "public interest" is really just a short form for the complex balancing of interests and prejudices that the court engages in, including consideration of the interests of secured and unsecured creditors, shareholders, workers, local governments, contingent creditors and others affected by the insolvency of the debtor corporation. The statutory language focuses on "creditor approval". This can, but does not necessarily act as a limitation in terms of affording a broader number of stakeholders a meaningful role. The current role of court-appointed officers may need some refining when measured against the proposals set out in my framework.

Chapter 4 examines the case managed process of the Ontario Superior Court of Justice, Commercial List as a highly effective prototype for CCAA and other restructuring processes. The Commercial List is not a separate court, but rather forms part of the Superior Court of Justice. It is the only specialized commercial list in Canada, although other jurisdictions have made an effort to designate certain judges as experts in commercial insolvency and bankruptcy matters. The Judges of the Ontario Superior Court of Justice Commercial List demonstrate an expertise and interest in the adjudication of commercial matters. They bring to the process case management and mediation skills that have made an invaluable contribution to the economic health of Canadian corporations and to international insolvency law. It is the availability of this

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26 A state of insolvency is a prerequisite for a debtor company to invoke stay, reorganization and extension of payment provisions in the CCAA, supra, note 5 and Parts III and X of the BIA, supra, note 5. Commercial insolvency under the BIA is defined as a person who is not bankrupt and who has assets or is carrying on business in Canada, whose liabilities to creditors are at least $1,000 and who is unable to meet obligations as they generally become due, has ceased paying current obligations, or the aggregate of whose property is not, at fair valuation, sufficient if sold to enable payment of all the debtor's obligations due and accruing due. For an overview, see Geoffrey Morawetz, "Developments and Trends in Companies' Creditors Arrangements Act Restructuring" (Canadian Bar Association Conference, Toronto, 1991) at 2.
specialized expertise and a strong commitment to expeditious and effective case management that has resulted in highly successful corporate restructurings and in the evolution of the notion of “public interest” as an important part of the equation.

Chapter 5 examines the recognition of workers as human capital investors through the study of Algoma Steel Corporation’s application under the CCAA. The 1992 case marked the first time that a trade union used Canadian insolvency law to propose a restructuring alternative to save a steel corporation and the economic and social life of a northern Ontario community.27 That restructuring and turn around of the economic health of the corporation would not have been possible without the protection afforded under the CCAA and without the skilled intervention of justices at the Ontario Court of Justice (General Division) Commercial List.28 The Algoma Steel case represents a major breakthrough in the court’s recognition of workers’ interests and in the acceptance by creditors of the role that workers and their bargaining agents can play in the development of effective plans of arrangement. The Court recognized the workers as creditors and, most importantly, as stakeholders that had a positive contribution to make to the negotiations for a new business plan. The success of that restructuring may help explain why courts and creditors are now more open to the notion that workers have investments at risk and that they have a meaningful role to play in assessing the future viability of the corporation.

Chapter 6 examines the recent judicial recognition of “social stakeholders” in CCAA proceedings. “Social Stakeholders”, as distinguished from creditors as economic stakeholders by the court, were expressly accorded both a procedural and substantive role in the 1998 CCAA application and then receivership of the Anvil Range Mining

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28 In 1999, the Court was renamed the Ontario Superior Court of Justice. Therefore the Commercial List was renamed Ontario Superior Court of Justice, Commercial List.
Corporation. Anvil Range, a company generating a quarter of the Gross Domestic Product of the Yukon, became insolvent and sought protection of the court. Although the *CCAA* application has now been continued as a receivership, the case represents an important precedent for the court in recognizing stakeholder interests beyond the very narrow paradigm of traditional creditors and shareholders. The Court expressly recognized the interests of workers, community, First Nations, and other stakeholders, according them not only a procedural role in the *CCAA* process, but considering their substantive interests. This represents a subtle but vitally important shift in the court’s approach to stakeholder interests in restructuring and reflects the willingness of the court to consider some of the notions set out in chapter 2.

The effectiveness of the case-managed process is illustrated in chapter 7 by the recent *CCAA* application of the Canadian Red Cross Society, in which there are multiple stakeholders with diverse interests and multiple jurisdictions involved. The Corporation’s insolvency was precipitated by the filing of hundreds of tort claims arising out of the transfusion of tainted blood. The role accorded stakeholders, including workers, contingent creditors and governments illustrates the valuable role that the statutory framework and court-supervised process play in Canada’s insolvency law. The case illustrates existing problems of defining public interest since most of the participants in the restructuring proceedings represented some compelling aspect of the “public interest”, including safe operation of a national blood system, continued disaster relief work, issues of job security and protection of pensions, and the health and welfare of transfusion claimants. *Red Cross* highlights the success of the current regime as measured against my conceptual framework.

Chapter 8 provides an analysis of the recent case of *Med-Chem Health Care Ltd.*, which was a *CCAA* application that was converted into a receivership. Here, the Union was granted a role in the restructuring process from the outset. However, when the *CCAA*
application failed, the Union sought to prevent the sale of the majority of assets of the corporation based largely on alleged violations of remedial labour relations legislation. The Court dismissed the Union’s request to consider a different proposal that would have preserved greater value for workers, landlords and trade suppliers, deferring to the recommendations of the Receiver and finding that labour relations matters belonged elsewhere. The Court’s conclusion that the issues raised by the Union are concerns exclusively relating to labour law, failed to give recognition to the interests and investments of workers as fixed capital and equitable claimants in the bankruptcy proceedings.

Chapter 9 draws lessons from insolvency regimes in five other countries. There is a rich legal scholarship of international comparative analysis and I do not attempt to replicate this work. Rather, I focus on the narrow question of how comparative restructuring schemes take account the issues raised by my conceptual framework, specifically, the public policy recognition of the value of workout schemes, notions of enterprise value maximization, and recognition of workers and other stakeholder interests in the insolvent firm. I conclude that internationally, different regimes have attempted to accommodate various interests through a variety of approaches and while the resulting schemes do not closely converge in their objectives, they do indicate a trend towards introducing policy instruments that afford a greater balancing of the interests affected in corporate insolvency. If one assumes that legal regimes tend to converge towards optimal outcomes, the trends towards greater balancing supports my thesis. Canada’s regime measures successfully in comparison, the CCAA providing an optimal balance of flexibility and certainty in aiding parties to the restructuring process. Thus, it is well situated to provide a more textured approach to the recognition of the public interest, particularly workers and others with a direct interest in the success or failure of the corporation.

In Chapter 10, my conclusions, I suggest that the CCAA process has not been adequately recognized for what it contributes to Canadian and international insolvency law. Current judicial recognition of both procedural and substantive roles for multiple stakeholders is a trend that is positive and ought to be encouraged as a means of enhancing value in corporate restructuring. Yet further definition of how interests are to be considered is necessary. In particular, the role of court-appointed officers, given the current judicial deference to their recommendations, needs further definition. I offer some lessons for new stakeholders seeking participation rights for the first time in CCAA proceedings. Ultimately, the goal is enhanced negotiation and optimal decision-making regarding the future of the insolvent corporation. The explicit recognition of all interests in the firm, including debt, equity and equitable investments is an important development, accompanied by a facilitative and supervisory role by the Courts.
CHAPTER 1

THE EXISTING CONCEPTUAL FRAMEWORK FOR RESTRUCTURING INSOLVENT CORPORATIONS

The word bankruptcy is derived from the Italian banca rota when medieval merchants would have their marketplace benches broken if they defaulted on payments. Restructuring suggests that debtors' benches should be fixed not broken and that creditors should be treated fairly, recognizing their diversity of interests.  

Creditori e lavoratori insieme possono riparere il banco, per aumentare il suo valore.

Insolvency law is aimed at allocating decision and control rights in the insolvent corporation, whether the ultimate goal or disposition is continuation of the business, sale as a going concern, or liquidation. Insolvency systems are an indispensable component of commercial economies and the particular system adopted by a jurisdiction usually reflects economic and societal choices regarding how to address firm failure. In this


31 “Creditors and workers together can fix the bench to enhance its value”. Translation into Italian: Sam Spano and Jean Spano.

32 Triantis notes that whether the outcome is liquidation or restructuring or some combination of these outcomes, the aim is to ensure the optimal use of assets as determined by the parties who value them the most. Triantis, supra, note 1 at 103.

33 American Law Institute, Transnational Insolvency Project, “International Statement of Canadian Bankruptcy Law, Preliminary Draft Number three” (Philadelphia: American Law Institute, 1996) [hereinafter American Law Institute] at 1, 3. The Transnational Insolvency Project includes practitioners
respect, insolvency law forms an important part of the corporate governance debate because it sets the framework for governance of the insolvent corporation during the decision-making regarding the future of the corporation. In this chapter, I briefly examine the historical origins of Canada’s restructuring regime in order to situate the current theoretical debate and to gain insight into the underlying purposes of Canadian insolvency law. I suggest that the legislative history of the CCAA is recognition of broad interests, leaving unresolved how this recognition should occur, a task that I hope to accomplish in this thesis. This is a timely exercise. In recent judicial pronouncements in CCAA cases, the court has recognized the interests of non-traditional creditors or stakeholders, utilizing terms such as the “public interest” or “social stakeholders”. These notions, while not entirely new concepts as will be seen by my discussion, nevertheless, had been largely ignored since the introduction of this restructuring legislation (the CCAA) in the 1930’s in Canada. I suggest that the re-emergence of the notion of interests broader than traditional creditor and shareholder interests is crucially important to the development of insolvency law.

I then examine the existing theoretical debate regarding the purpose of insolvency and bankruptcy law, including debates about the relevance of public policy or public interest in the context of private commercial law. Given the broad scope of this debate, I limit my analysis to those aspects relevant to development of my conceptual framework for the governance of the insolvent corporation, particularly the corporation that is seeking to restructure its affairs with a view to becoming economically viable. My conceptual framework set out in chapter 2 builds on both debt collection and enterprise wealth maximization theories discussed in this chapter. The theorists also assist in developing a determination of how traditional creditor interests can be reconciled with those of other diverse stakeholders who have investments at risk in the corporation. While corporate restructuring should only occur where there is the possibility for successfully enhancing

and scholars from Canada, the United States and Mexico. Its purpose is to facilitate co-operation among the three signatory jurisdictions to NAFTA and assist in structuring transnational transactions of insolvent corporations.

34 See for example Anvil Range Mining Corporation and Skydome Corporation, discussion in chapter 6, infra.
value, workers and other stakeholders have important informational and human capital to contribute both to the negotiation process for the development of plans or proposals and to the successful turn-around of the restructured corporation. If these contributions are important, then the restructuring process must develop incentives for such participation.

A. Origins of the Canadian Restructuring Regime

The current Canadian insolvency regime is analyzed in some detail in chapter 3. However, a brief discussion of the historical origins of the regime offers insight into the original underlying purposes of Canadian restructuring legislation. My view is that the historical background foreshadowed the importance of a scheme that recognizes multiple investments in the corporation and that offers a mechanism to avoid premature liquidation. While the reconciliation of interests reflected by those investments was not fully articulated at the point that the legislation was enacted, the history of the CCAA sets the stage and provides guidance for development of the framework that I set out in chapter 2.

The historical origins of the CCAA recognized interests broader than just shareholders and traditional creditors. The original legislation endorsed the notion that it was in the public interest to afford corporations the opportunity to reorganize as an alternative to liquidation and its attendant costs. The historical perspective also provides the foundation on which to explore the current theoretical debate in this chapter about the underpinnings and efficacy of restructuring statutes.

35 By premature liquidation I mean that the corporation is liquidated even though the value that would accrue to satisfy creditors' claims (however, broadly or narrowly creditor is defined) would be greater if the firm were continued than if it were liquidated.
The *CCAA* was enacted in May 1933.\(^{36}\) Its enactment must be understood in light of existing bankruptcy legislation at the time. The federal *Bankruptcy Act* had been enacted in 1919 after an almost forty year gap in the existence of national bankruptcy legislation.\(^{37}\) The impetus for this legislation was a wave of commercial failures and the result of creditor groups lobbying for consistency in the administration of bankrupt estates across the country.\(^{38}\) The 1919 bankruptcy legislation applied to both companies and individuals for the first time, and allowed debtors to make compromise proposals prior to bankruptcy, subject to creditor approval and court sanction.\(^{39}\) Telfer points out that the 1919 legislation was a product of private initiative, not public policy, driven by creditors. The creation of a formal proposal scheme was thus not aimed at debtors, but rather, was a strategy by traditional creditors to ensure that where they worked out arrangements with debtor companies, they had the ability to bind minority and dissenting creditors through court orders.\(^{40}\) Creditors wanted a system in which there was some formal mechanism to allow debtors to negotiate a proposal or compromise with creditors. This, along with the availability of bankruptcy discharge, meant that creditors were able to preserve where possible the companies as future debtors.\(^{41}\) However this early legislation did not bind secured creditors and thus undermined its effectiveness because

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\(^{36}\) *An Act to Facilitate Compromises and Arrangements between Companies and Their Creditors*, S.C. 1933, c. 36, 23-24 George V., Royal Assent May 23, 1933.

\(^{37}\) *Bankruptcy Act*, S.C. 1919, c. 3. Early bankruptcy legislation in Canada dates back to 1869 and was aimed primarily at traders. It was repealed in 1880 because of the amount of fraud and abuse by debtors, and numerous provincial statutes were enacted (and constitutionally upheld) to fill the void until national bankruptcy legislation was enacted in 1919. Richard McLaren, *Canadian Commercial Reorganization, Preventing Bankruptcy* (Toronto: Canada Law Book, 1999) at 1-4, 1-6.


\(^{39}\) *Ibid.* at 392. The majority of creditors and two-thirds in value of the claims were required before the court would approve the proposal.


\(^{41}\) *Ibid.* at 363.
secured creditors could defeat a proposal by moving to enforce their claims. Telfer also notes that the proposal provisions of the legislation received little scrutiny at the time they were enacted, the focus being on the efficient administration and liquidation of estates and the forgiveness/punishment role of bankruptcy. Notions of corporate rehabilitation were absent from the debates.

Amendments to the Bankruptcy Act were enacted in 1923 as the result of abuses of debtors and unqualified trustees; these amendments disallowed proposals for restructuring or compromise before bankruptcy. Given that it is very difficult to revive a company once it has reached the point of bankruptcy, these amendments essentially defeated almost all efforts to restructure companies facing financial difficulties, leading in turn to a number of premature liquidations.

Thus by 1933, existing legislation such as the Bankruptcy Act and the Winding Up Act essentially provided only for liquidation of a company under a trustee in bankruptcy or a liquidator. Yet growing capitalization and concentration of wealth in existing enterprises meant that when a firm experienced financial difficulty, the effects of

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43 In 1919 there was still considerable controversy about whether a stigma should attach to bankruptcy, i.e. the notion that bankruptcy was usually the result of mismanagement, versus the recognition of bankruptcy resulting from a number of market and other factors and thus occurring through no fault of the managers. Telfer, supra, note 38 at 393, 401.

44 McLaren, supra, note 37 at 1-6. L. Duncan and W. Reilley, Bankruptcy in Canada, 2d ed. (Toronto, Canadian Legal Authorities Ltd., 1933) at 168.

45 Winding Up Act, R.S.C. 1906, c.144, now the Winding Up and Restructuring Act, R.S.C. 1985, c. W-11. McLaren, ibid. at 1.650 to 1.2450. The Companies Act, 1907, section 38 specified that the Joint Stock Companies’ Arrangement Act, 1870, (JSCAA) 33 & 34 Vic. C. 104 should apply to a company not in the course of being wound up. The Insolvency Act, 1869, 32-33 Vic. C. 16, repealed 1880, 43 Vic.; the Insolvency Act, 1875, 38 Vic. C. 16 then applied to all companies. The Canada Companies Act (CCA) of 1908, s. 45, was confined to two models of reorganizing share capital, the consolidation or division of share capital into different classes. It was then extended in 1928 to apply to all reorganization of share capital. Prior, the CCA permitted reorganizations of both shareholders and creditors’ interests in the 1870’s and 1880’s. See also Companies Act, 1900, 64 Vic. C. 104, which declared that the JSCAA applied to both shareholders (members) and creditors. When the Bankruptcy Act, 1919 was enacted, amendments were made to the CCA to drop creditors’ arrangements, hence the need to proceed conjointly under more than one statute where the arrangement involves a share restructuring. Duncan and Reilley, ibid. at 1107, 1127.
dissolution of the company were economically more important than they had been in previous years. While the drive for legislative change was as a result of debtor corporations seeking a means to restructure prior to bankruptcy, there was public awareness that firm failure affected not only the owners of the company, but creditors and employees as well. Thus the CCAA was introduced to facilitate compromises and arrangements between companies and their creditors.

Secretary of State C. H. Cahan, in introducing the CCAA in 1933, noted that the limited mechanisms under the existing statutes inevitably resulted in the entire disruption of the corporation, depreciation, loss of goodwill, and sale of assets on a discounted basis. Cahan pointed out that there had been no means by which creditors could reach an amicable settlement between themselves and the company’s managers, or a compromise of debt in such a way as to permit the company to continue in business through reorganization. The Government introduced the legislation because of the “prevailing commercial and industrial depression” and advocated adoption of a method by which the courts could supervise the arrangements and compromises between creditors without the improvident sale of assets of the firm.

The Government based the legislation on the British Companies Act of 1929, which provided for compromises with creditors and which set out value amounts of support required before the courts would endorse the plan. The government of the day was

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47 That objective was reflected in the title of the legislation itself, An Act to Facilitate Compromises and Arrangements between Companies and Their Creditors, supra, note 36.


49 Ibid. at 4091.

50 Ibid.

51 Ibid. The 1933 legislation required a majority of creditors by class and three-quarters in value to approve the plan before the Court would sanction it. These amounts were based on the required amount under British legislation. Companies Act, 1929, 1929, c.23 (U.K.) McLaren, supra, note 37 at 1.200.
careful not to trench on provincial jurisdiction and thus the legislation did not address approval of classes of shareholders, specifying that provincial law would apply with respect to provincially incorporated companies and the compromises or arrangements of shareholders.\textsuperscript{52} The court was empowered, however, to hear applications which proceeded conjointly under the \textit{CCA\textsubscript{A}} and provincial corporations law, in order to facilitate compromises and arrangements.\textsuperscript{53} In introducing the original legislation, the Government stressed that the intention was to group classes of creditors by those creditors having the "same" interest, and that these creditors would decide among themselves as to the terms of compromise of their interests.\textsuperscript{54} Of note is that one of the express purposes was to provide a mechanism to bind both secured and unsecured creditors, unlike proposals under pre-existing bankruptcy legislation.\textsuperscript{55}

The Bill was widely circulated throughout Canada in advance of its introduction and was speedily passed through the Parliament and the Standing Committee on Banking and Commerce.\textsuperscript{56} The House of Commons Debates are scanty and there were no minutes recorded for the proceedings of the Standing Committee on Banking and Commerce.\textsuperscript{57} There were references to the need to preserve companies on a going concern basis and to address the prevailing commercial depression. Indication that there was an awareness of the public interest involved, including concern for workers, was more prominent in the Senate Debates on the \textit{CCA\textsubscript{A}}. The Honourable Arthur Meighen, in presenting the Government's bill, said: "the depression has brought almost innumerable companies to the point where some arrangement is necessary in the interest of the company; in the

\begin{footnotes}
\footnote{Cahan, \textit{supra}, note 48 at 4091.}
\footnote{\textit{Ibid.}}
\footnote{Secretary of State Cahan, Committee as a Whole Debates on \textit{CCA\textsubscript{A}} (9 May 1933) (Ottawa, King's Printer, 1933) at 23.}
\footnote{Unlike the \textit{Bankruptcy Act} then and the \textit{Bankruptcy and Insolvency Act} before 1992. \textit{Ibid.} at 23-4.}
\footnote{\textit{Ibid.} at 23. Second reading (24 April 1933), third reading (9 May 1933).}
\footnote{This was confirmed by Bob LeRiche, Reference Librarian, Parliamentary Library, House of Commons, Ottawa, telephone interview (24 April 1999) and (26 April 1999). Apparently no record of such proceedings was a common practice at that time.}
\end{footnotes}
interests of employees, because the bankruptcy of the company would throw the employees on the street, and in the interest of security holders, who may decide that it is much better to make some sacrifice than run the risk of losing all in the general debacle of bankruptcy. Thus as early as 1933, legislators recognized the harm caused by complete loss of investment in the firm by creditors and by employees. Preventing the loss of goodwill and protecting employees from the harm of loss of employment were express objectives of the Government enacting the legislation, reinforced by the scholarly commentary of the time.

The original CCAA was apparently viewed by trade creditors and unsecured creditors as inadequate to protect their interests because of the amount of control debtor corporations were able to exercise in the restructuring process. As a result, a bill was introduced in 1938 that sought to repeal the legislation because of the prejudice to trade creditors. The CCAA was not repealed, but rather, the debate continued sporadically with respect to the amount of control exercised by debtor companies. Given that the statute fell into disuse, there was little to drive the amendments. In 1953 the CCAA was amended to limit access to it to companies that had issued bonds or debentures under a trust as a means to limit its use to larger companies, the rationale being that there was less opportunity for debtor corporations to act entirely self-interestedly in the CCAA process when they were publicly held. During this period, the CCAA appears to have been aimed at facilitating

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59 Ibid. at 475; Edwards, supra, note 46 at 598-590.

60 McLaren, supra, note 37 at 1-15, such creditors were largely unprotected because of the absence of a trustee who was representing their interests.


62 This appears to have been without the benefit of empirical evidence, since there were almost no cases filed under the CCAA. Edwards, supra, note 46 at 591.

63 More recently, courts recognized the creation of instant trust deeds to by-pass this requirement and in 1997 the requirement was eliminated from the statute. McLaren, supra, note 37 at 1-16.
the reorganization of companies with complicated public debt structures and where there was an indenture trustee to monitor or control the corporation. Scholars have called it a "legislative curiosity that was never intended to operate as a general reorganization statute", but note that many years later it has gained in popularity because of the willingness of the court to deal with secured creditors and because of its effectiveness in dealing with complex financial restructuring.

The CCAA was to provide a means by which insolvent companies could continue business operations through a rearrangement of rights of creditors and shareholders. The underlying notion was that if the creditors receive only the liquidation value of the corporation, they would receive considerably less than the value might be as a going concern. As a consequence, plans of arrangement or compromise sought to allot amounts to creditors that at least preserved the liquidation value of their claim. From the inception of the scheme, it was aimed at providing for plans that were fair and equitable. Legislators were cognizant of the fact that the power to bind dissenting creditors should not be used to confiscate their legitimate claims. Thus, the CCAA was originally enacted with a policy objective of providing a mechanism by which insolvent companies could avoid bankruptcy through "workable and equitable" restructuring plans. As Stanley Edwards pointed out as early as 1947, Canada continued to be dependent on and vulnerable to world markets, and thus, it was particularly important that an adequate

64 American Law Institute, supra, note 33 at 10; McLaren, supra, note 37 at 1.2350-1.2400.

65 American Law Institute, ibid. at 10-11. See also McLaren, ibid. at 1.2350 for a discussion of how the statute was originally aimed only at companies with an indenture trustee. The most significant amendments to the CCAA were enacted in 1992 and 1997. Ziegel, supra, note 2 at 760. It was not until recently that the BIA was amended to allow for proposals that bound secured creditors. Thus the CCAA offered the only court-supervised option for restructuring which included the secured creditors.

66 American Law Institute, ibid. at 587. The original legislation also enabled debtor companies to seek and obtain extensions on stays in order to allow them to present a plan of arrangement without risk of bankruptcy.

67 Ziegel et al, supra, note 2 at 517.

68 American Law Institute, supra, note 33 at 3.

69 Edwards, supra, note 46 at 589.
Restructuring procedure exist in Canada so that any depression would not permanently injure the Canadian economy through the discontinuation of firms.70 Edwards argued that an effective reorganization scheme would assist in preserving going concern value of insolvent companies that have a good chance of survival, would prevent the loss of many workers’ jobs, and would help ensure that investors and creditors were not deprived of their claims or the opportunity to share in the value of future activities of the company.71 His commentary, considered one of the most thoughtful of the period, reinforces my assertion that the legislation originally had a broader purpose than merely allowing traditional creditors to bind dissenting creditors.

From 1933 to 1947 the CCAA was rarely invoked. There were only seven judgments that dealt with or referred to the CCAA and none discussed the merits of restructuring plans.72 However, there is some early indication that there was public policy recognition of the value of workouts. In 1947, the Quebec Court of Appeal held that the purpose of the legislation was remedial and rehabilitative, and that the purpose of the court’s discretionary power was to assist with effecting a successful restoration of the business enterprise if the requisite creditor approvals of a plan of arrangement had been accomplished.73 Edwards wrote that same year that:

Reorganization may give to those who have a financial stake in the company an opportunity to salvage its intangible assets. To accomplish this they must ordinarily give up some of their nominal rights, in order to keep the enterprise going until business is better or defects in management can be remedied….it is in the interests of the public to continue the enterprise….especially if it employs large numbers of workers who would be thrown out of work by its liquidation, …and this (public interest) is undoubtedly a

70 Ibid. at 590.

71 Ibid.

72 Ibid. at 591. Edwards reported that the courts tended to approve the plans if there was the requisite amount of creditor support. See for example: Re Dairy Corporation of Canada Ltd. (1934), 1 O.R. 436, the first judgment setting out the tests for determining whether the plan is fair and reasonable.

factor which the court would wish to consider in deciding whether to sanction a plan under the CCAA.\textsuperscript{74}

Edwards noted that consumer, investor and employee interests as well as the public interest generally were concerned with the reorganization of companies, and that these interests should be borne in mind by those supervising the restructuring.\textsuperscript{75} Successful implementation of the legislation required that parties recognize as much as possible the nominal legal rights of classes to participate in the value generated if the reorganization was successful.\textsuperscript{76} Thus, early commentary supports my assertion that the CCAA was enacted to facilitate restructuring plans in such a way as to recognize the interests of workers, trade suppliers and communities.

There is also historical support for my view that decision making regarding the future of the corporation is enhanced if the governance decisions take account of the interests of all those with investments at risk. Edwards argued that the court, in rendering an informed and independent judgment, must consider all points that could possibly affect the decision because restructuring involved not only shareholders and creditors but the public generally and that "it would be inauspicious for the review to be confined to questions raised by creditors and shareholders at the hearing".\textsuperscript{77} Informed judgment was to include adequate data as to what factors of public interest are involved, an understanding of the conflicts of interest between those with an interest in the corporation, valuation of the assets if they were to be liquidated, and estimate of future probable earnings of a reorganized company, in order for the court to fully protect the interests of the public, employees, minority creditors and shareholders.\textsuperscript{78}

\textsuperscript{74} Edwards, \textit{supra}, note 46 at 592-3.
\textsuperscript{75} \textit{Ibid.} at 594.
\textsuperscript{76} \textit{Ibid.} at 597.
\textsuperscript{77} \textit{Ibid.} at 600.
\textsuperscript{78} \textit{Ibid.} at 601, 614.
Thus the underlying purpose of restructuring legislation, while creditor driven in its origins under the *Bankruptcy Act*, was by the time that the *CCAA* was enacted, concerned with interests broader than just those of shareholders and traditional creditors. The legislative history of the *CCAA* illustrates that employment and other economic effects on communities have from the inception been important considerations. The regime has historically supported in broad strokes the importance of productive use of human capital and consideration of workers’ interests. However, there is no historical direction as to how this was to be accomplished other than an indication that this was to be part of judicial decision-making. There is no indication in the early cases or scholarship that workers were to be given greater voice. Rather, the notion was that the court was to consider workers’ interests and those of other stakeholders, even though they were not present before the court. As will be seen in chapter 3, the courts have undertaken just such an exercise. However, with the recent appearance of unions, tort claimants and other stakeholders in *CCAA* applications, it is timely to consider precisely how such interests should be accounted for in restructuring proceedings, a task I hope to accomplish in the next chapter.

The *CCAA* essentially fell into disuse for almost fifty years, and notwithstanding its existence, Canada’s insolvency system historically favoured liquidation. It was not until the increased use of the *CCAA* in the past decade that there has been a shift towards a regime that encourages restructuring.\(^{79}\) This is explored in some detail in chapter 3. When Part III of the *Bankruptcy and Insolvency Act* was amended in 1992 to facilitate restructuring of insolvent small and medium size enterprises, there was some debate regarding the necessity of having two restructuring statutes.\(^{80}\) The *CCAA* was left intact at that time in order to provide a period in which to assess whether the *BIA* proposal provisions would be effective in replicating the restructuring mechanisms under the *CCAA*. The 1997 amendments to bankruptcy and insolvency legislation did not include

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\(^{79}\) This was reinforced by amendments in 1992 to the *BIA* to facilitate proposals, *supra*, note 5.

\(^{80}\) See for example, Ziegel, *supra*, note 7 at 108.
repeal of the *CCAA*. Rather, the *CCAA* was amended to make it more accessible, to restrict its use to larger companies, and to conform with provisions of the *BIA*.

In the intervening period, there has been considerable theoretical debate about the objectives and future of insolvency and bankruptcy law. Much of this theoretical debate arises in the context of U.S. bankruptcy proceedings under Chapter 11 of the U.S. *Bankruptcy Code*. The debate centres around both the policy objectives and policy instruments that are of value in the governance of financially distressed corporations. In chapter 2, I propose a systems framework that includes four key components: a substantive objective in governance of insolvent corporations of enterprise value maximization; a recasting of fiduciary obligation to take account of all of those with investments at risk in the firm; a recognition of equitable investments in the firm, such as workers' human capital investments that are greater than the amount suggested by their fixed claims; and a scheme that continues to recognize and balance traditional creditors' rights with these other interests in the firm. These components suggest both policy objectives and policy instruments in their successful implementation. The current theoretical debate about bankruptcy and restructuring assists in laying the theoretical foundation for my ideas in the following chapter.

**B. Current Theoretical Approaches to Restructuring**

Many jurisdictions have developed elaborate schemes for the determination of priorities in bankruptcy, as well as companion schemes that afford debtor corporations the

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81 Ziegel argues that it is poor public policy to retain a separate scheme and that debate regarding dismantling of the *CCAA* never seriously occurred because of its popularity as a restructuring tool in the 1990's. *Ibid.* at 121.


opportunity to restructure their affairs and make arrangements with creditors in order to allow the corporation to remain as a going concern. All systems have as competing outcomes, liquidation and reorganization. The legislative scheme adopted can act to facilitate or discourage these outcomes and the variety of hybrid arrangements that they generate. The interests of various creditors and other stakeholders converge and diverge around the issue of these competing outcomes. Most regimes provide for both liquidation and restructuring, because, as will be seen throughout this thesis, in addition to competing, the availability of these options can be complementary. Adoption of a specific regime may reflect in part the particular society's notion of the moral blameworthiness or lack thereof of a corporation's financial difficulty. The American Law Institute has pointed out that the insolvency systems chosen by various jurisdictions tend to reflect the underlying values of the society as well as its commercial development. While "fairness" to all parties with an interest in the corporation is a factor, the choices reflect preferences for liquidation or reorganization, as well as preferences for particular stakeholders because of their economic interests at risk or because they are particularly vulnerable to firm failure.

While the focus of this thesis is restructuring, it is important to situate corporate workouts in the broader framework of bankruptcy and liquidation. Liquidation usually involves the sale of assets on a piecemeal or going concern basis to a third party. Reorganization or restructuring involves a plan or proposal being devised in which the assets of the corporation are essentially sold to the creditors and/or other stakeholders through a conversion of debt to equity, compromises of the amount of claims owing or timing of

84 Liquidation schemes are straight forward, have few administrative costs, societal expectations are not high in terms of recovery of claims and inefficiencies in the system are more difficult to measure. Reorganization regimes are costlier to administer and the very nature of negotiations results in a certain amount of fractiousness between parties. American Law Institute, supra, note 33 at 47.

85 Triantis, supra, note 1 at 108.

86 American Law Institute, supra, note 33 at 47.

87 Ibid. at 2.
payments, refinancing agreements or the injection of new equity investment in the firm.\textsuperscript{88} However, restructuring can also result in arrangements that are a hybrid of the two, such as sale or liquidation on a going concern basis or liquidation of part of the business in order to finance restructuring of the rest of the enterprise.\textsuperscript{89}

The general premise underlying a restructuring scheme is that where the corporation is worth more as a going concern than liquidated on a piecemeal basis in terms of satisfying traditional creditors’ claims, there should be an option in which creditors and other parties can negotiate a workout. These restructuring regimes allow parties to craft proposals,\textsuperscript{90} plans of arrangement or compromise,\textsuperscript{91} reorganizations,\textsuperscript{92} schemes of administration,\textsuperscript{93} redressements,\textsuperscript{94} and other plans. All these terms refer to statutory schemes setting out a procedure for the negotiation or crafting of viable business plans that afford the debtor corporation an opportunity to stay in business in an effort to become economically viable. Most regimes have provisions for the temporary suspension of creditors’ rights to enforce their claims while the debtor corporation is attempting to devise a restructuring plan. Many schemes also have court-appointed officials that monitor, oversee or actually manage the corporation during this period. Often the court-supervised process assists with the collective action and transaction costs among the firm’s diverse creditors and between creditors, directors and officers, thus ensuring more value extracted from the firm and avoiding premature liquidations.\textsuperscript{95}


\textsuperscript{89} Triantis, supra, note 1 at 103.

\textsuperscript{90} BIA, supra, note 5.

\textsuperscript{91} CCAA, supra, note 5.

\textsuperscript{92} U.S. Bankruptcy Code, supra, note 83.

\textsuperscript{93} Insolvency Act, 1986, United Kingdom, P. II, ss. 8 – 27 [hereinafter IA].

\textsuperscript{94} Loi no. 85-88 relative au redressement et la liquidation judiciaire des entreprises, Law Nos. 85-88 and 85-89, Decree Nos. 85-1388 and 85-1389, France.

\textsuperscript{95} Hon. Richard Posner, Chief Judge, U.S. Court of Appeals for the Seventh Circuit, “Foreword”, Corporate Bankruptcy, Economic and Legal Perspectives, in Bhandari and Weiss, supra, note 88 at xi.
this thesis, the terms “restructuring” and “workouts” are used generally to refer to these processes and the issues they raise. When referring to specific legislation, I make reference to the particular statutory terminology and requirements.

In Canada, as in many jurisdictions, there is a statutorily enacted hierarchy or priority of claims reflecting the country’s normative choices regarding credit. Schwartz, writing about the U.S. scheme, points out that such hierarchies often reflect three operating principles. First, unsecured creditors, unless given preferential treatment by statutes, share on a pro rata basis with other unsecured creditors regardless of when their claims arose. Second, if an unsecured loan exists and a later creditor takes security, the later secured creditor’s claim takes priority. Third, the initial creditor making a secured loan generally has priority over later secured credit except where statutes have created specific provisions for security over particular assets. In Canada, purchase money security interests are a good example of this. Thus, whether the insolvent corporation is to be restructured or liquidated on a going concern or asset basis, the scope of these transactions will depend in large measure on the particular rights and priorities of creditors and others with interests in the corporation.

Legal scholarship has made an important contribution to our understanding of the rationale behind restructuring regimes. This scholarship has enhanced our understanding of why governments in many jurisdictions have concluded that it is important to have an alternative to liquidation and to have a means by which corporations can work out their affairs. Interestingly, there is an apparent gap between insolvency literature and the literature discussing effective corporate governance for the solvent firm. Although one might conclude that this is because when the firm reaches insolvency, a whole new bankruptcy regime takes effect and traditional notions of efficient governance do not apply, in reality many of the same theoretical underpinnings drive decision-making in solvent and insolvent corporations. For example, governance decisions involve efficient

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97 Ibid.
use of assets, accountability to residual claimants, and containing transaction costs. A key difference in the literature regarding governance of solvent as opposed to insolvent corporations, is that insolvency scholars recognize the normative underpinnings of choices of models. Thus, for example, where market theorists in discussing solvent corporations argue against the importation of normative considerations, they fail to acknowledge the normative underpinnings that exist in market theory. In contrast, bankruptcy scholars, even those endorsing market theory, may differ strongly in the policy objectives they advocate, but often expressly recognize that these are normative choices, whether one advocates preferences for a debt collection or a rehabilitation model.98

The current theoretical debate centres on both the policy objectives and policy instruments that should be adopted in bankruptcy and insolvency law. For example, the debate around policy objectives focuses on whether there should be a substantive goal of rehabilitation of the corporation. It also considers whether consistency in the approach of corporate governance in the insolvency and solvency regimes should be a substantive objective, i.e. whether there are compelling reasons to treat various stakeholders the same or differently depending on corporate solvency. The debate around policy instruments includes the procedures that should be adopted, how decision making should occur, and the process by which competing interests are recognized or accounted for. This debate regarding policy instruments is distinguishable from policy objectives because it leaves open the possibility of any outcome depending on perceived efficiency, wealth maximization or other principles. However, these issues are not separate and they converge at various points in the debate.

The systems framework that I set out in chapter 2 advocates a policy objective of enterprise value maximization, having regard to all those who have investments at risk in the corporation. The policy instrument includes according diverse interests participation

98 Jackson, supra, note 88 at 57.
and decision rights in the restructuring process. The framework does not require endorsement of a model that advocates rehabilitation as the substantive goal of insolvency law. However, I conclude that rehabilitation is often the course that will best meet the objective of enterprise value maximization and best recognize the diverse interests of all of those with equity capital, debt, human capital and other investments in the corporation.

In this chapter I also draw parallels between corporate governance theories generally and theoretical approaches to governance during insolvency and restructuring. These connections are necessary to understanding my conceptual framework set out in the next chapter. Elsewhere I have argued for an expansion of fiduciary duty to require decision making in the best interests of the corporation having regarding for both equity investments and human capital investments. This theoretical approach applies to governance of insolvent corporations as well. If anything, the rationale for directors and officers having a broader fiduciary duty is much stronger in the insolvency context where creditors and employees have become residual claimants to the value of the firm's assets. While the model that I advocate in chapter 2 is equally applicable to solvent and insolvent corporations, even if one is not persuaded by my arguments with respect to the solvent corporation, the framework stands effectively on its own for the insolvent corporation.

Scholars have defined corporate governance as the legal and practical system for the exercise of power and control in the business of a corporation. Governance includes the relationship of shareholders, directors and board committees, officers of the corporation and other constituencies such as traditional creditors, workers, major customers, suppliers and local communities. Jeffrey Gordon has defined corporate

99 See the discussion at notes 341-350, infra, for a definition of these rights.

100 Sarra, supra, note 27.

101 W. Grienenberger, supra, note 24 at 621.

102 Kissane, supra, note 24 at 621-3.
governance as the mechanisms by which various marketplace signals directly influence the composition of the management team, which in turn both influences and makes the economic decisions of the firm. He describes corporate governance as a function of five elements: the statutory regime that imposes duties on directors and officers; the common law fiduciary duties that constrain actions; mandatory disclosure requirements of securities systems and regulation of proxy voting by shareholders; the corporation's internal governance procedures; and the structure of share ownership.

While Gordon's work focuses on the solvent corporation, these elements are equally applicable to the situation of the insolvent firm. For example, the governance questions that are raised when creditors and managers consider whether the firm should be restructured instead of liquidated include questions about statutory liability and securities law obligations. The availability of additional financing from institutional investors, so-called "vulture funds" and more traditional lenders is directly affected by the statutory restrictions and requirements in terms of both priority of such security and concentration of holdings. As will be seen in chapter 3, the issue of common law and statutorily imposed fiduciary obligation is a key element, including the issue of when and how directors and officers acquire a fiduciary obligation to creditors. The share structure and ownership may have an impact on whether it is feasible to restructure, including the transaction costs involved in altering share structure or corporate articles, and the facility with which there might be a workout that includes conversion of debt to equity.

The following discussion of the current theoretical debate regarding the policy objectives and instruments advocated by bankruptcy scholars illustrates that there continues to be lively dispute about the law's substantive goals. Much of the theoretical debate has

103 Gordon, supra, note 9 at 1474. Gordon points out that products and capital markets in particular directly influence the makeup of managers.

104 Internally governance includes decisions such as the ratio of inside to outside directors, board composition and size, and the existence of poison pill mechanisms. Ibid. at 1475.

105 Axel Flessner has set out a spectrum of theories including the "pragmatism" model in which workouts happen on a case by case commercial basis; the "capitalist" model or what Jackson has more appropriately called "debt collection theory", in which the sole purpose of restructuring regimes is to provide for orderly decision-making to maximize the aggregate value of creditors' claims; the "forum or enterprise" approach
been generated by American scholars. The United States has a much more extensive history of restructuring, which has sparked considerable discussion about the scheme's value and efficiency.\textsuperscript{106} I examine these theories with a view to discerning what is helpful to the framework set out in the following chapter.

\textbf{i. Market Theory Approaches to Insolvency}

Most scholars endorse the value of restructuring schemes, although they vary considerably in their policy objectives. For example, market theorists have as a policy objective the efficient operation of markets and thus restructuring schemes as a policy instrument should only exist to clarify priority of creditors' claims, to assist with liquidation or the smooth transition of control to creditors.\textsuperscript{107} Thus while there may be some value to an insolvency scheme, comprehensive legislation is viewed as unhelpful to the commercial resolution of cases. Their view is that market forces alone should decide how to maximize creditor return and whether a corporation should be liquidated or can become commercially viable through a private workout.\textsuperscript{108} This approach parallels finance and market theories of corporate decision-making for the solvent firm, which start from the premise that the primary goal of the corporation is to maximize share value

\begin{footnotesize}
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\item It is important to note that "bankruptcy law" in the U.S. refers to what Canadian law would refer to as "insolvency law". Restructuring is generally called reorganization in the United States and these terms are reflected in the legal scholarship.
\item Flessner notes that early American and United Kingdom insolvency law was representative of this model. Flessner, \textit{supra}, note 105 at 21.
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as measured by share price.\textsuperscript{109} These theoretical approaches are premised on governance models that advocate commercial decision-making based on market ordering.\textsuperscript{110} Finance theorists suggest that once a firm is insolvent, bankruptcy law should be aimed at encouraging low cost private market workouts. Products, financial and other markets should be the sole determinant of whether firms should survive. Absent the availability of a private workout in any particular case, it is more efficient to sell the firm on a going concern or liquidated basis, deploying the assets and human capital elsewhere in the market. These scholars generally suggest that public law should not intervene to rescue companies and compromise creditors’ claims, because such strategies add transaction costs without creating efficiencies.

Market theory has come under sharp criticism because markets alone rarely determine any decisions in modern commercial economies. Margaret Blair suggests that finance and market models fail to recognize today’s realities of legal and economic regulation by the state in terms of corporations statutes, securities regulation and competition statutes, in which the state has intervened to assist corporations and equity investors.\textsuperscript{111} Triantis and Lopucki observe that the market is only one component that contributes to a system’s ability to achieve the objective of successful restructuring of insolvent corporations, and that a number of economic, legal and political factors influence outcomes more than narrow assessment of commercial viability.\textsuperscript{112} These are valid criticisms. However, market theory does assist in consideration of an insolvency framework in that it helpfully reminds us that any restructuring scheme must take account of markets, because once the

\textsuperscript{109} Finance theory suggests that the current price of shares fully reflects the market’s best estimate of the value of all future profits. Thus the interests of shareholders as the residual owners of the corporation are best served by corporate decisions that maximize short-term share value. Macey has called this “managerial horizon”, where short-term share price takes priority whether or not it is a measure of good corporate decision making. J. Macey, “Comparative Corporate Law” (Lecture to Faculty of Law, University of Toronto, 1996).

\textsuperscript{110} Margaret Blair has suggested that a competing theory, “market myopia” theory, merely adds a short-term/long-term dimension by suggesting that the use of financial markets as an accurate indicator of future value acts as a bar to long-term decision-making, Blair, supra, note 107 at 203, 209-10.

\textsuperscript{111} Ibid.

protection of the statute is lifted, markets will be a major determinant of the survival of the debtor corporation. Markets are important indicators of future economic viability, and the shift to global markets has seriously influenced governance of the insolvent corporation during the period of decision making regarding its future. Any restructuring plan that is devised must create efficiencies and enhance the value of the corporation such that it will be able to successfully compete in the market place. Insolvency law must be situated in the social and economic context in which the regime operates, recognizing that multiple factors affect restructuring decisions, beyond narrow assessment of commercial requirements on an individual case by case basis.

\[\text{ii. Rehabilitation Theory}\]

Another dominant theoretical approach that informs us of the value of restructuring schemes is “rehabilitation theory” in which the primary policy objective is preservation of the firm as an ongoing entity. France, Italy and the United States are examples of this type of model.\(^{113}\) The underlying premise of this theoretical approach is that insolvent corporations may be so important to national or local economies that these interests take precedence over the original capital investment of shareholders and creditors. Thus, the state is justified in rolling back existing creditor and shareholder claims in order for the firm to attract new capital and engage in enhanced economic activity.\(^{114}\)

\(^{113}\) \textit{Ibid.} at 122.

\(^{114}\) \textit{Ibid.} As will be seen in chapter 9, while the economic and political contexts may be different, there are comparative lessons to be learned in how workers and other stakeholders are given rights to participate in the restructured corporation in such regimes. The rehabilitation approach bears some resemblance to the “social welfare” theory of corporate governance in which the policy objective is a system that operates to ensure that the corporation serves a broad social purpose, premised on normative notions of social justice, liberty and the right of workers to decent wages. These theorists argue that notwithstanding the injection of capital by shareholders and creditors, a key objective is the creation of meaningful employment and economic stability for local communities and the policy instrument to achieve this is to require decision-making to be undertaken with a view to this broader social entity concept of the corporation. J. Coffee, "Unstable Coalitions: Corporate Governance as a Multi-player Game" (1990) 78 Georgetown Law Journal 1495 at 1523. J. Singer, "The Reliance Interest in Property" (1988) 40 Stanford L.R. 611.
The difficulty with a pure rehabilitation model is that there are considerable numbers of insolvent corporations that are worth more on a liquidated basis than as a going concern. If the primary policy objective is rehabilitation, this does not adequately account for the problem of deferred liquidations, i.e. liquidations that should occur but are delayed by a regime that accords too much value to the objective of rehabilitation. In terms of consideration of diverse investments in the corporation, rehabilitation may not always benefit the greatest number of stakeholders. Deferred liquidation can in fact place secured creditors, trade creditors and workers' human capital investments at further risk because it requires continuing investment in the insolvent firm.\footnote{At best, workers may be temporary recipients of limited benefit from deferred liquidation because their jobs are extended for a few months. However, given both the high levels of firm loyalty and the undiversified nature of their investment, as discussed in chapter 2, deferred liquidation acts to induce their further human capital investment when the firm is not viable and ultimately fails. It acts to prevent workers from trying to mitigate the harm from job loss by finding retraining and new employment.} If a corporation is preserved that is not economically sound, nor has the potential to become sound, then workers and other non-traditional creditors will be induced to continue investing human and other capital and will suffer even greater losses when the firm ultimately fails. Deferred liquidations may work to the exclusive benefit of shareholders in that they are able to maintain the existence of the corporate entity even in cases where there is no hope of devising an effective business plan or gaining the support of the majority of creditors. As will be illustrated in chapter 9, this is one of the key deficiencies of the U.S. rehabilitation model. Corporations enter reorganization proceedings for years, to the detriment of traditional and non-traditional creditors, and ultimately the firm fails because the singular policy objective of rehabilitation was not sufficient to overcome the deficiencies in terms of a workout acceptable to creditors. Thus I am not advocating a pure rehabilitation model in chapter 2.

A different version of this theoretical approach is the view that rehabilitation as a policy objective should be aimed at assisting debtors, creditors and the community at large.\footnote{Nathalie Martin, “Non-economic Interests in Bankruptcy Standing; on the Outside Looking In” (1998) 59 Ohio State L.J. 427 at 433-37.}
The most recent articulation of this approach has been by Karen Gross who argues for a humanistic vision of U.S. corporate bankruptcy law as the policy objective.\textsuperscript{117} She suggests that the current objective of creditor wealth maximization in bankruptcy proceedings is too narrow, that American bankruptcy law should be revised to recognize that debtors, creditors and communities are interconnected, and that discharge or reorganization should be based on notions of “forgiveness, fresh start, and rehabilitation”.\textsuperscript{118} She challenges the broadly accepted assumption that participants in bankruptcy proceedings act entirely self-interestedly, and instead evokes philosophical, religious and economic reasons why parties will act for the well being of others.\textsuperscript{119}

Gross suggests as the policy instrument that current bankruptcy law should be amended to recognize creditors based on size and impact of non-payment, no matter what their priority or security, and that definitions of classes could reflect those considerations.\textsuperscript{120} The presumption of equality of treatment of creditors’ claims would continue, but a creditor could rebut the presumption by demonstrating that equality in distribution would be unconscionable or create extreme unfairness or irreparable injury.\textsuperscript{121} The court could then exercise its equitable jurisdiction to change the distribution based on equality of outcome as opposed to equality of treatment.\textsuperscript{122} She also argues that courts should expressly take account of community interests in cases where there is a nexus between


\textsuperscript{118} Gross argues that debt forgiveness is humane, encourages risk taking, and has economic benefits that allow the debtor company to choose between liquidation and reorganization. Gross, \textit{ibid.}, at 2, 102, 115, 138.

\textsuperscript{119} \textit{Ibid.} at 6, 7.

\textsuperscript{120} Thus, payouts to creditors might be the same value but payments could be accelerated for those for whom the loss had the greatest impact. The presumption of equality of treatment of creditors would continue to apply, however, it would be based on a more carefully defined relationship and creditors “in need” would be paid more than creditors less needy. She suggests that this is analogous to fresh start. The mistake in lending should not lead to loss of the creditors’ business. \textit{Ibid.} at 144, 164, 167.

\textsuperscript{121} Tort claimants and involuntary creditors (except government) should be able to rebut the presumption of \textit{pro rata} distribution upon showing substantive unconscionability. \textit{Ibid.} at 165, 247.

\textsuperscript{122} \textit{Ibid.} at 165, 249.
the debtor corporation and harm to community. Gross does not answer the practical questions of who would represent the community or who would bear the cost of its participation in the proceedings, leaving such decision making to the court.

Criticisms of Gross' work tend to focus on the policy instrument that she advocates. Gross places enormous weight on the equitable powers of bankruptcy judges and their inherent ability to make judgments regarding "humane considerations" that would recognize community interests. Second, scholars have pointed out that Gross uses bankruptcy law as a vehicle for social change and that taking community interests into account is impracticable and would internalize the costs of bankruptcy to the firm by making existing claimants pay for the social and economic costs of firm failure. Moreover, scholars take issue with her contention that secured claims should be subordinated to other claims. These criticisms are valid if the idea is to import judicial discretion into consideration of broad interests without regard to the economic and legal system in which the corporation is operating. A scheme that allows judicial discretion to override statutory priorities for credit without consideration of which investments are at risk in the firm, does leave decision making vulnerable to the discretion of the court. It would also create uncertainty for traditional creditors in their decisions regarding risk assessment and the granting of credit prior to insolvency.

123 Gross distinguishes herself from communitarians in that she is not advocating a broad social welfare model, only a policy that takes account of a community touched by the financial distress such that it is entitled to seek relief under bankruptcy law. She would place the onus on the community to establish that it qualifies as a party. *Ibid.* at 207, 210-212.

124 Gross would amend the U.S. Bankruptcy Code to require that the court take the interests of community into account unless the balance of equities clearly favours denial of these interests, *ibid.* at 228.

125 *Ibid.* at 244; Block-Lieb, *supra*, note 117 at 473.


127 On grounds that the tortfeasors, i.e. managers as agents of shareholders, are better able to assess and avoid risk of harm to community than are secured creditors. The public policy issue is whether to alter shareholder limited liability regimes as they relate to torts. Susan Block-Lieb, "The Unsecured Creditors' Bargain" (1994) 80 Va. L. Rev. 1989 at 1995;
While most insolvency schemes do involve distribution of value to creditors, often not on a strict priority basis in terms of their claims, the decision to compromise those claims should be left largely to those with the claims, not exclusively to ad hoc judicial decision making. Moreover, if judges are exercising discretion in a scheme of rigid credit priorities, it is unlikely that community or other interests will trump more traditional creditors' claims except where the harm is so egregious that the stakeholder would likely have a claim in tort or on some other common law basis. If the scheme allows the exercise of judicial discretion only for unconscionable outcomes, then the exercise of discretion will be infrequent because the nature of harm, while serious, likely would not fall within defined notions of unconscionable harm. Where Gross' ideas may have merit is her requirement that the community establish some sort of nexus of harm with the activities of the corporation. The challenge would be how to establish this is a manner that can quantify the harm and thus the claims to some of the value of the assets of the debtor corporation while still controlling transaction costs. Consideration of broader interests has merit, but should arise where there are either investments of a human capital or other economic nature that are deserving of some sort of residual claim on the value of the assets of the insolvent corporation or where there are claims arising from tortious or similar conduct. These are notions that I develop in chapter 2.

Scholars have argued that wealth creation does ultimately benefit society and that this is the appropriate role for corporate governance, rather than consideration of community interests that will create excessive transactions costs and inhibit wealth creation. These scholars view consideration of worker and other stakeholder interests as benevolent or public law activities. They fail to account for the human capital investments made by workers in the corporation. However, the issue of controlling transaction costs is a legitimate concern for insolvency law, with or without the added participation of diverse stakeholders. The challenge is whether one can craft a policy instrument in which diverse interests are recognized, but the process is efficient, controls transaction costs, and assists in generating value for the corporation.

128 Frost, supra, note 126 at 130.
Another theoretical approach that has gained recognition in the United States and Germany is "debt collection" theory, which focuses on the assets of the debtor corporation and the policy objectives of maximizing the value of creditors' claims to those assets and facilitating the collection of those debts. Thomas Jackson and Douglas Baird's scholarship are both illustrative of this theoretical approach. Jackson suggests that bankruptcy's normative policy objective is to collectivize the process by which a debtor's assets are made available to claimants.129 Baird argues that bankruptcy law's efficacy should be to overcome creditors' co-ordination problems regarding the common pool of assets, and that the only policy objective of bankruptcy law should be the enhancement of collection efforts of creditors with a view to maximizing creditors' wealth.130 This can only be accomplished effectively if non-bankruptcy creditor priorities are identified and translated into the bankruptcy forum.131 Bankruptcy law should not alter the relative priority among claimants, but rather should acknowledge the inherent tensions between creditors of varying priorities that induce them to react differently to insolvency.132 While bankruptcy law should help a corporation carry on business if it is worth more to creditors as a going concern than wound up, an


131 Jackson, *supra*, note 129 at 58; Baird, *ibid.*, at 822.

independent policy objective of bankruptcy should not be rehabilitation because it does little to reconcile the diverse interests of creditors. Financing and investment decisions are different, and whether the firm should continue operating is a distinct issue from who owns the corporation's assets. While bankruptcy law affects numerous other areas of the law such as environmental and labour law, debt collection theorists argue that it is a mistake to utilize bankruptcy law as a policy instrument to undertake accommodation of other rights. Baird does not believe that existing U.S. bankruptcy law adequately protects workers, but suggests that this should not be a substantive goal of bankruptcy law. The key policy instrument of bankruptcy law is as a collective debt-collection device. It sets out limits on what creditors can take from debtor corporations when debts are greater than assets, and as a policy instrument, creates a forum for deciding entitlements among creditors when assets remaining are insufficient to cover all their claims.

Debt collection theorists suggest that reorganization must be viewed conceptually as a form of liquidation in which the business entity is sold to the creditors themselves because the assets are worth more to creditors as claimants than they would be if sold to third parties. The decision to restructure instead of liquidate is one that should be made solely on the basis of which strategy generates the greatest aggregate dollar equivalent return on the assets for creditors. This determination is distinct from a

133 Jackson, supra, note 129 at 2; Baird, ibid. at 33.

134 Baird, supra, note 130 at 820.

135 Jackson, supra, note 129 at 2.

136 Baird, supra, note 130 at 815. He notes that he is not making any assumptions about what the substantive rights of workers should be, only that there should be no difference between pre-bankruptcy and bankruptcy entitlements.

137 Jackson, supra, note 129 at 3-5.

138 When the firm is restructured, proceeds from the "sale" of the corporation out of which claims against the debtor corporation will be paid, are primarily new claims against the same firm. Determining the value of the payment to creditors without using a market pricing mechanism is, according to Jackson, the hallmark of a reorganization plan. Ibid. at 53, 212.

139 The greatest net gain to the common pool will be achieved from a restructuring as opposed to liquidation. Jackson, supra, note 129 at 213-4.
determination as to what claims are outstanding against the firm's assets. Corporations should be afforded the opportunity to reorganize if it increases the pie available for satisfying claims but leaves intact the non-bankruptcy entitlements to shares of the pie.\textsuperscript{140} If a workout is worth more to creditors in terms of retaining their interest in the corporation, either in the form of debt or debt converted to equity, then the restructuring provisions of bankruptcy law should facilitate this. If not, the firm should be sold and there should not be an independent goal of trying to keep the firm operating. Thus, for debt collection theorists, the key question is how to convert ownership of the assets of the debtor corporation to the creditors and how to reduce the costs of that conversion, not the question of how to leave the assets with the debtor.\textsuperscript{141} A key challenge of bankruptcy law is to translate the multi-farious claims of secured and unsecured creditors, varying maturity of claims, and claims from contracts that offer specific performance as the remedy for breach, into comparable forms for purposes of allocation.\textsuperscript{142}

The principal contribution of debt collection theorists to development of my conceptual framework is the notion that a policy objective of insolvency law is to mitigate collective action problems. Where we would differ, as will be evident in chapter 2, is that my definition of creditor would be considerably expanded to take account of more than just fixed capital claims. I also conclude that a scheme that facilitates collective action problems is not antithetical to one that has a policy objective of facilitating a turn-around of the business affairs of the insolvent corporation where appropriate. Where rehabilitation and debt collection theorists have been unable to reconcile their respective differences is the gap between the objective of rehabilitation at all or at considerable cost to the interests of creditors, versus an objective of satisfying creditors claims without regard to the contribution that the corporation may make to the economic life of the

\textsuperscript{140} Jackson, \textit{ibid.} at 72. See also T. Jackson and D. Baird, eds., \textit{Problems and Materials on Bankruptcy}, 2\textsuperscript{nd} ed. (Boston: Little Brown and Company, 1990) at 25.

\textsuperscript{141} Jackson, \textit{supra}, note 129 at 5.

\textsuperscript{142} Jackson urges development of a coherent normative theory that deals with inter-creditor interests and that allows development of principled rules that respect non-bankruptcy entitlements. Jackson, \textit{ibid.} at 59-61.
community in which it operates. I suggest that these views are extreme and that there is considerable scope for a more balanced approach that adopts elements of both theoretical approaches.

One can endorse a policy objective of encouraging workouts where there is a viable business plan and support of the majority of creditors without converting that objective into one of rehabilitation at all costs to traditional creditors and other residual claimants. Similarly, one can endorse the policy objective of effective debt collection while still endorsing the notion that there should be some limited period in which the debtor corporation can try to secure the support of creditors and other stakeholders for a restructuring plan that does maximize the value of their claims and that does allow for effective transfer of that value to creditors. While I agree with Baird that insolvency law affects other areas such as environmental and labour law, I disagree that there should be no balancing. The entire scheme of a common law jurisdiction is a balancing of complex aspects of private and public law. Courts have to deal with the realities of the situations in front of them and these fact situations are rarely purely "commercial law" matters. In corporations law this balancing or weighing of prejudice is frequently accomplished in terms of balancing private commercial activity with shareholder remedies or balancing economic activity with director liability for environmental harm. To suggest that bankruptcy law should always trump and thus does not require an accommodation with other substantive law ignores what currently occurs with the solvent corporation. Since Baird and Jackson argue for consistency in and out of insolvency, then application of these kinds of balancing considerations becomes an important policy instrument in any restructuring scheme.

Having made that observation, I note that Baird does raise important questions that have not been answered by scholars arguing for special consideration for broader stakeholder interests in insolvency law and which need to be taken into consideration in developing a coherent framework. First, given that many firms close, fail or settle reorganization plans outside of court-supervised protection, and such cases ignore the problems of workers and other stakeholders, why should considering such losses be a policy objective for
bankruptcy law alone. Baird questions why those least able to bear the costs of firm failure or closure are given status in bankruptcy, but bear the costs outside of bankruptcy. Moreover, he challenges the notion that creditors should bear the burden of special priority for workers and others in bankruptcy when shareholders are not required to bear this burden outside of bankruptcy. Baird argues that creditors should not be different from new owners in or out of bankruptcy vis a vis obligations to workers, and that legal rights should turn as little as possible on the forum. If not, this will encourage parties to forum shop in the sense of structuring their activities to use or avoid the bankruptcy process motivated by distributional concerns, such as using insolvency proceedings to escape onerous contractual obligations.

These are important considerations that I explore in chapter 2. I conclude that workers and other creditors that can establish investments in the firm should have some substantive rights in and out of insolvency, and in and out of court-supervised processes. This would answer Baird’s concerns, avoid forum shopping, and enhance corporate decision-making. While I do not endorse consistency for consistency sake in and outside of bankruptcy, Baird and Jackson offer compelling reasons why there should be consistency in the normative underpinnings of governance of solvent and insolvent firms. These arguments provide the foundation for my suggestions in chapter 2 regarding participation and decision rights of non-traditional creditors in the governance of the corporation.

\[143\] Baird concludes that one cannot argue for a special set of distributional concerns arising when a debtor defaults to many creditors at one time. Baird, supra, note 130 at 822.

\[144\] Baird points out that there are also plant closures, massive lay-offs, or private workouts, and that there is no protection of workers until creditors have evoked bankruptcy law, thus, why should this law differ. Ibid. at 818.

\[145\] Baird, supra, note 132 at 100.

\[146\] Ibid.

\[147\] By decision or control rights, I refer to the right to formally vote on plans, to assist in decision making regarding the future of the corporation. By participation rights, I mean the right to participate in negotiations for the plans, to have interests considered as part of the discussions, the right to sit on
Scholars who take issue with debt collection theory argue that there is no common pool of assets to which creditors have a claim prior to bankruptcy and that the notion of a common pool of assets derives entirely from the bankruptcy scheme that allows for the orderly recognition and settlement of creditors' claims, depending on the particular hierarchy set out in the statutory scheme. They suggest that credit is usually given with the expectation that the corporation will continue to operate and thus will generate income to ensure repayment of debt and payment of interest that accrues to creditors; the assumption is not that creditors will only have their claims satisfied through sale of the assets. While this may be true, secured creditors usually also factor the risk of non-payment and of firm failure into interest costs. The creditors' right to payment derives from the right to a portion of the income generated either from the economic activity of the firm or from proceeds of the forced sale of the assets of the corporation.

Other scholars suggest that debt collection theory has made normative choices about the values that reorganization schemes should enshrine, i.e. existing pre-bankruptcy legal entitlements. They challenge the notion that bankruptcy law need only protect pre-insolvency rights to the exclusion of any other considerations, such as adjustment costs and economic havoc to communities. The approach of debt collection theorists does, however, mirror the dominant theoretical approach to governance of solvent corporations that explains and reinforces notions of maximization of share value as the singular and optimal goal of corporate decision-making. For example, the law and economics view creditors' committees, to participate in the court-supervised process or the private efforts to mediate or negotiate a plan.

148 Flessner, supra, note 105 at 25.

149 Ibid.

150 The ability to repay debt is affected by numerous factors including the contributions made by workers, suppliers, and managers, and by the requirements to comply with various statutory laws. Ibid. at 25.


152 Mark Kessel, "International Aspects of Corporate Governance, A United States Perspective" (Canadian Bar Association Conference on Corporate Governance, A National Perspective, Vancouver, 1997) at 2. Blair, supra, note 107 at 3, 16.
of the corporation as a nexus of contractual relations concludes that directors and officers
are the agents of shareholders and should be accountable exclusively to them in order to
ensure decision making which results in the maximization of shareholder value. Economic theorists argue that the market promotes efficient and accountable use of resources and thus those investing share capital or their agents should have exclusive carriage of decision making. This will create efficiency and maximize wealth to the ultimate benefit of society. As a result, economic theorists do not recognize that corporate decision-makers have any obligation to act in the interests of workers or other stakeholders such as local government and communities. While some of these theorists acknowledge that there may be others who have an interest in the success of the corporation, they advocate that any rights of suppliers, employees or community ought to be strictly limited to contractual and statutory rights.

These governance theories are grounded in property rights and notions of residual ownership of the assets of the corporation. As a consequence, when the firm becomes insolvent, the directors and officers of the corporation, while still agents of the shareholders, now have an obligation to account to creditors in terms of deciding the most efficient use of resources. If they fail to do this, creditors will move to enforce their claims through liquidation. Creditors and shareholders are "owners" of the firm in the sense of having claims to the value of the assets by priority: secured creditors, preferred creditors, unsecured creditors, preferred shareholders and common shareholders.


154 Daniels suggests that wealth creation of the corporation benefits society, but distinguishes this from a social welfare view. Ron Daniels, "Stakeholders and Takeovers: Can Contractarianism Be Compassionate" (1993) 43 U. T. L. J. 315 at 351.

155 Blair, supra, note 107 at 18, 49.


157 Baird and Jackson, "Corporate Reorganization", supra, note 130 at 97, 105.
Instead of shareholders owning a proportional share of the value of the residual assets of the corporation, the creditors now acquire the right to a proportional share of the value of the corporation's assets in order to satisfy their claims. While not strictly ownership in terms of title, at least at the point the firm becomes insolvent, the entitlement to proceeds from disposition of assets carries with it property claims. Just as in the solvency context, in insolvency these theories suggest that the issue of employment is one that should be left to private market ordering or to separate public employment law regimes.\footnote{Lynne Dallas, "The Relational Board: Three Theories of Corporate Boards of Directors" (1996) 22 The Journal of Corporation Law 1 at 8.}

For the solvent corporation, the theoretical approaches to governance reflect these value-maximizing goals. For example, widely accepted agency cost theory views corporate governance as having a singular objective of maximizing shareholder value by controlling managerial abuse while minimizing agency costs associated with its monitoring and prevention.\footnote{Performing functions based on the expertise of directors, acting as arbiters of internal labour markets. However, boards need not monitor if this can be accomplished by less costly methods such as aligning managers' interests with those of shareholders through compensation by stock ownership. Dallas, \textit{ibid.} at 16. C. Bathala and R. Rao, "The Determinants of Board Composition: An Agency Theory Perspective" (1995) 16 Managerial and Decision Econ. 59 at 61; E. Fama and M. Jensen, "Separation of Ownership and Control" (1983) 26 Journal of Law and Economics 301 at 315; O. Hart, "An Economist's View of Fiduciary Duty" (1993) 43 U. T. L. J. 299 at 303.} Other theories differ in their approach, but are aimed at the same objectives. Narrowly cast to maximize shareholder wealth and reduce transaction costs, they do not take account of other investments in the firm.\footnote{Dallas, \textit{supra}, note 158 at 7, 22. For example, "contra-managerial hegemony theory" is aimed at countering pressures that create board member dependence on managers; advocating rules to allow access to information independent of managers and strategies to deal with the problems of influence and time constraints.} For the insolvent firm, agency theory addresses how to minimize transaction costs in the realization of creditor claims, the focus on shareholder wealth maximization and control rights shifting to an almost identical focus on traditional creditors' wealth maximization. This shift is premised on the fact that there is little or no equity remaining in the corporation and that any claims to the assets of the corporation have shifted primarily or exclusively to creditors.
The dominant theoretical approaches to corporate governance have been reinforced by statutory language and judicial interpretation. The legal standard of director and officer liability has remained fairly constant since the inception of the modern corporation. Courts have given judicial deference to business judgements that maximize shareholder wealth, assessing the process of corporate decision making as opposed to the correctness of the decision. Theory and practice converge to create and legitimize a view of corporate governance narrowly cast to take account of shareholder interests. Consistent with this approach, when directors and officers fail to govern effectively, or market or other forces place the firm in financial difficulty, any opportunity to continue decision making necessitates that managers have regard to the new "owners" of the corporation, the traditional creditors. Given the structure and hierarchy of credit in our society, this really means secured creditors who usually can lay claim to most of the insolvent corporation's assets.

These theories are problematic because their definition of interest recognizes only equity and debt capital investment in the firm and ignores the other investments that contribute value and which may be vitally important to decision-making in terms of wealth maximization. The challenge for my framework is therefore how to account for all investments in the firm and how to devise a governance structure that encourages decision-making that will maximize value while simultaneously controlling transaction costs.

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162 John Howard, "The Changing Role of the Corporate Director" (Canadian Bar Association Conference on Corporate Governance: A National Perspective, Vancouver, 1997) at 1-2.

163 Ibid. at 2, 3, 6. Howard suggests that in the absence of conflict of interest or complete abdication of role, a director is unlikely to be found in breach of a common law or statutory duty of care.
iv. **Enterprise Theory in the Governance of Insolvent Corporations**

Some of the concerns that I have identified may in part be addressed by enterprise theory. There is growing scholarship that recognizes that modern economies are made up of enterprises that are reflective of interests broader than traditional creditors and shareholders. This theoretical approach is not aimed at any particular economic results, but rather, represents an effort to move away from the narrow view that the policy objective of bankruptcy law is to maximize value in the interests of asset claimants.\(^{164}\)

The notion of maximizing enterprise value during the restructuring process is different than maximizing the value of equity.\(^ {165}\) This approach suggests that bankruptcy and insolvency law should have as both policy objective and key policy instrument the establishment of a forum where all the interests can be heard from regarding the possible restructuring of the insolvent corporation. Stakeholders such as employees, suppliers, customers, and local governments have an interest in the workout, even if their interest is not translatable into current capital claims.\(^ {166}\)

Elizabeth Warren’s scholarship is an example of this theoretical approach. She suggests that the fundamental policy objective of bankruptcy law is to provide an orderly approach to debt collection and co-ordination of the hard decision making in the assessment of whether to restructure or liquidate.\(^ {167}\) Its objective is also to enhance the value of the corporation, to distribute value according to multiple normative principles, to internalize

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\(^ {166}\) *Ibid.* See also Warren, *supra*, note 151 at 777.

the cost of business failure to the parties dealing with the debtor corporation, and to enhance private monitoring. The objective is to provide a means to deal with a debtor corporation’s multiple defaults and to distribute the consequences of financial distress among the different parties. Bankruptcy law is designed to distribute assets and losses when the business cannot meet its financial obligations.

Warren suggests that reorganization also serves the distributional interests of those who have an interest in the corporation’s continued existence, but who are not technically creditors. She includes in this list, older employees unable to retrain for new jobs, suppliers who lose current customers, and state and municipal governments facing a reduced tax base. Thus bankruptcy policy should rationally consider the effects on those who are least likely to spread the risk of default and are unable to bear the costs of firm failure. Warren points out that the definition of enforceable contract already recognizes these types of concerns through doctrines such as impossibility, duress and unconscionability. Thus, restructuring schemes should acknowledge losses of those depending on the continued operation of the enterprise and redistribute some of the risk of loss from the default. She argues that the objective of bankruptcy law is to

169 Warren’s scholarship suggests that bankruptcy law is an extension of a normatively based law creating a coherent system of promise enforcement. Thus, contracts require a party to perform what is promised, to pay the money equivalent, or to discharge the promise through the bankruptcy system, the third being the necessary escape valve in a system of enforceable promises. Warren, supra, note 151 at 779.
170 Thus, for Warren, bankruptcy policy becomes a composite of factors encompassing competing and conflicting values as to how losses are to be distributed. Elizabeth Warren, “The Untenable Case for Repeal of Chapter 11” (1992) 102 Yale Law Journal 437 at 467.
171 Warren, supra, note 151 at 787.
172 She points out that almost every substantive amendment to U.S. bankruptcy law in the past two decades has been aimed at redistributional concerns. Warren, supra, note 170 at 468.
173 Warren, supra, note 151 at 788.
174 Ibid. at 775, 776. She notes that anyone who extends credit does so at the risk of not being repaid, and that interest is structured to pay creditors for assuming that risk of non-payment.
175 Ibid. at 788.
distribute the costs among those at risk having regard to relative ability to bear the costs of default; to create incentive effects on pre-bankruptcy transactions; identify similarities of interest among creditors; to ensure that shareholders bear the loss when the business fails; and to balance the equities in terms of benefits to the bankruptcy estate. The difficult question, both normatively and empirically, is what are the values to be protected in the distributional scheme and whether the implementation scheme is effective in protecting such values. Equally important is whether this can be accomplished in a timely manner.

This approach parallels the theoretical work of scholars such as Margaret Blair and Lynne Dallas on corporate governance. Blair suggests that on firm failure, the consequences to workers with specialized skills and to key suppliers are serious because often they do not have alternative markets for their labour or supplies. While this has been recognized in terms of traditional creditors’ claims in current restructuring schemes in negotiations for workouts, it has not been explicitly recognized in terms of investments such as human capital. Blair concludes that these decision-making rights should not be limited to insolvency situations, those with investments in the corporation should have access to decision and control rights when the corporation is solvent. She argues that while shareholders should not be disenfranchised, control rights in the corporation should reflect a clearer understanding of both ownership and investments at risk, concluding that employees and creditors may have as much claim in this respect as shareholders.

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176 Ibid. at 791-92.

177 Warren suggests that even if winding up the firm is the ultimate outcome, the delay involved in the bankruptcy process gives those relying on the business an opportunity to accommodate the forthcoming change. Ibid. at 796-8.

178 Blair, supra, note 107 at 189.

179 Ibid. at 239.

180 Ibid. at 236. She suggests that this may also be the case where the corporation is solvent.
Dallas’ work focuses on theories of boards of directors, advocating a model that formally recognizes those stakeholders that have an interest in the success of the corporation.\textsuperscript{181}

These scholars advocate a governance model that endorses a policy objective of enterprise wealth maximization, taking into account the broader interests of stakeholders. Enterprise wealth maximization differs from traditional creditor wealth maximization in that the latter is aimed at maximizing the existing capital claims on the assets of the corporation without regard to those who have made human capital or other investments in the firm. Enterprise wealth maximization attempts to view wealth maximization for creditors beyond those traditionally enforcing their capital claims to include other kinds of investments in the firm. Some of these notions are incorporated in the policy objectives that I advocate in chapter 2. While I do not endorse the notions of “ownership” argued by these theorists, I agree that the system should recognize interests and investments in the firm beyond fixed capital claims. The policy instrument by which to accomplish this differs from some of these theorists because I suggest that it must involve granting participation and decision rights to such stakeholders as a means of optimally achieving the policy objectives. The challenge is how to determine the scope and application of fiduciary obligation that may arise out of a policy objective of enterprise wealth maximization.

Criticisms of enterprise theory include a claim that private law should not concern itself with public policy, and that if governments want to protect the interests of other stakeholders, they can enact statutory protection under labour, environmental and other remedial legislation.\textsuperscript{182} The criticism is that bankruptcy law sets a priority for settlement of claims and that injecting other decision-making rights into restructuring will harm

\textsuperscript{181} Dallas, supra, note 158. Similarly, Black suggests that residual interest and control rights should be measured in the short to medium term, not at the point of liquidation, when business decision-making is still active and more directly affects the risks of firm gain or loss. Bernard Black, “Corporate Law and Residual Claimants” (Columbia University School of Law, Centre for Law and Economic Studies, 1996) [working paper, cited with permission] at 19, 36.

\textsuperscript{182} Macey and Miller, supra, note 156 at 417.
those priorities. Scholars object to the importing of what they characterize as social policy into bankruptcy policy in which insolvent firms have a special obligation to protect employees, suppliers or other interests in a manner that non-bankrupt firms do not. Scholars have also suggested that importation of stakeholder interest will lead to judicial uncertainty in decisions and increased transaction costs. Some of these concerns are legitimate and are addressed in the conceptual framework proposed in the next chapter. The vigour of the debate regarding the objectives and instruments of bankruptcy law is in itself a product of different normative choices of these theorists.

In Canada, on the whole, the statutory scheme that facilitates corporate workouts affords traditional creditors the opportunity to participate in negotiations for a plan or proposal. This is with the aim of simultaneously protecting creditors’ rights and assisting the debtor corporation in restructuring its affairs in an effort to become solvent. Similarly, court-appointed officers are often directed to assist with the development of a plan, having regard to the protection of creditors’ claims. In many respects, as will be illustrated in chapter 3, historically the Canadian insolvency regime has most closely resembled the debt collection theory with a slow but consistent move along the spectrum towards both rehabilitation and enterprise models in recent years. For solvent corporations, clearly the shareholder wealth maximization model continues to be the dominant theoretical approach to Canadian corporate governance, reinforced by both corporations statutes and judicial pronouncements. During insolvency, Canada’s regime shifts primarily to a creditor-oriented process. However, it does not entirely adopt debt collection theory because shareholders are given a role in negotiations for workouts and there is an express public policy of allowing debtor corporations the opportunity to devise a plan to restructure their affairs. As will be seen, Canadian courts are reluctant to grant continued stays if the debtor corporation has not been able successfully to gain the support of key creditors. That support is premised on creditors maximizing the value of their claims through restructuring as opposed to liquidation.

The recent shift in Canadian insolvency law towards more of a balance between the debt collection, enterprise and rehabilitation models is analyzed at some length in the case
studies in chapters 5 to 8. Courts have made reference to “public interest” and “social stakeholders” in determining the participation rights of workers, tort claimants, local governments and other stakeholders. Yet this shift necessitates three observations. First, Canadian courts have continued to emphasize that this is ultimately a creditor-driven process. Second, frequently the argument for the “public interest” is being made by the debtor corporation or traditional creditors to bolster their own position in whatever issue is before the court. Some of the stakeholders that arguably comprise part of this “public interest” are often not before the court, either because they have some traditional claims and rights to participate in restructuring proceedings but are unaware of those rights; or because their interest and thus participation rights in the corporation are unclear. Even where stakeholders can establish a claim such that they are recognized creditors, often they do not have the information or resources to participate in the negotiations for a workout or in the court-supervised process. As will be seen in chapters 5 to 8, any recent move towards a greater balancing of interests has occurred where workers or other stakeholders have the information and resources to appear and seek an active role in the restructuring process.

Third, it is worth noting that this recent shift along the restructuring spectrum has created some discordance with corporate governance theory generally. There is no indication that the courts are shifting their views of property-based notions of shareholder wealth maximization that have so strongly characterized corporate caselaw. Yet in insolvency, there is marginally less reluctance to intervene to accord at least participation rights beyond a narrow creditor wealth maximization model. I suggest that this is because courts are reluctant to divest shareholders of all decision rights in the restructuring process, notwithstanding the fact that they often retain no equity in the corporation at the point of insolvency. The recognition of these participation rights for shareholders opens the door for recognition of other interests not strictly defined by fixed capital claims.

The above theories greatly contribute to our understanding of where the insolvent corporation is situated and what policy objectives and instruments are available in restructuring schemes. In chapter 2, I draw largely on the work of debt collection and
enterprise theorists. I endorse the public policy objective of having a scheme of restructuring as an alternative to liquidation. The framework recognizes that the interests of stakeholders, including traditional creditors, diverge and converge, and thus there must be mechanisms to facilitate resolution of collective action problems. I endorse the notion of enterprise wealth maximization having regard to all investments at risk in the firm. While fulfilling this objective may result in rehabilitation, it is neither a necessary outcome nor necessarily the substantive policy objective. The restructuring regime should protect diverse interests, particularly those interests that have undiversified risks such as workers and local communities. I agree with Baird that consistency in and out of bankruptcy, and consistency in and out of court-supervised processes is a necessary part of an effective insolvency scheme. Where we differ is that I define creditors more broadly than fixed capital claims and I recast fiduciary duty of directors and officers to take account of all of the firm's investors, including traditional creditors, workers, and other stakeholders. By doing so, the interests of these stakeholders receive the same level of protection inside and outside the insolvency regime. However, as will be evident in chapter 2, even where the reader does not feel compelled to endorse these notions for the solvent corporation, my framework of enterprise wealth maximization, fiduciary obligation to a broad definition of creditor, and recognition of participation and decision rights for investors can be endorsed as an effective "stand alone" theory of governance in restructuring of insolvent corporations.

C. Indicia of Effective Corporate Governance in the Turn Around of the Insolvent Firm

Scholars have pointed out that there is not a shared definition of what constitutes a successful restructuring regime. As the above discussion illustrates, this is because the indicia vary depending on the normative choice of policy objectives and instruments. Depending on whether the objectives are efficient debt collection, rehabilitation or
enterprise wealth maximization, the indicia of effective governance will measure outcomes by the policy objective. Successful restructuring can be measured by size of return to creditors over the short-term, by actual confirmation of a plan, by successful retention of jobs,\(^1\) by costs incurred in the process,\(^2\) or by the financial state of the corporation some years later. For example, White suggests that the rehabilitation objective of the U.S. bankruptcy scheme causes too few businesses to liquidate in a timely fashion, generating inefficiencies by delay of movement of assets to more productive uses, and that this is the measure of an inefficient regime.\(^3\)

Before setting out my own conceptual framework, it is helpful to consider what factors are likely to contribute to the successful turn-around in the economic health of an insolvent corporation.\(^4\) Just as I have drawn on a range of normative theories as aids to designing a conceptual framework in chapter 2, here I draw on indicia suggested across a range of normative theories. Rather than discuss these by theoretical approach, I discuss them in terms of the policy objectives and policy instruments of an effective insolvency regime.

\section*{i. Achieving the Policy Objectives}

In chapter 2, I discuss the policy objectives that I advocate for an effective restructuring regime. These policy objectives include: encouraging timely and cost-effective

\(^1\) Gross, \textit{supra}, note 30 at 120.

\(^2\) Michelle White, “The Corporate Bankruptcy Decision” in Bhandari and Weiss, \textit{supra}, note 88 at 207, at 226-7. White suggests that bankruptcy costs play an important role in the choice of outcome. There are direct administrative costs for legal fees, trustees, and appraisers, and there are indirect costs such as lost sales and profit, and value forgone. She does not mention impact on employees or others as indirect costs.

\(^3\) \textit{Ibid.} at 227.

\(^4\) The question of what factors are necessary to the economic health of firms has been the subject of extensive study and scholarly debate, and is too complex a question to deal with comprehensively here. Thus I highlight only a few key indicators.
negotiations for a viable restructuring plan acceptable to creditors and other investors; achieving a substantive objective of enterprise wealth maximization; substantive recognition of all interests in the insolvent firm; and finally, balancing recognition of rights and priorities of traditional creditors with these other interests. It is helpful in crafting that framework to consider what indicia have been considered by scholars and practitioners as important to measure the successful achievement of such objectives.

Frost suggests that in measuring the success of a restructuring, one must commence with a recognition that insolvency law has simultaneously competing objectives of maximizing creditor recovery, preservation of going concern value where possible, and preservation of jobs and communities affected by firm failure. Recognition of these multiple policy objectives also means recognition of where interests converge or diverge on any particular set of facts. Frost concludes that value maximization as the sole indicium fails to capture all of the policy objectives. Successful restructuring must thus be measured by consideration of the extent to which some or all of these policy objectives have been met by the continued operation of the firm, specifically, maximization of creditor recovery, benefits to workers, trade suppliers and surrounding community.

Second, in terms of the objective of maximizing enterprise wealth, Margaret Blair suggests that this can be measured by whether production has been maximized; whether there is a resultant generation of consumer surplus and overall welfare of the enterprise; whether the corporation has provided opportunities for workers to become more productive; whether greater flow of profits to investors has been generated than would occur if they invested elsewhere; and whether the flow of benefits to suppliers or

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188 Ibid. at 123.

creditors is such that this is a more optimal use of their capital and supplies than directing their resources elsewhere. Effective turn-around may occur where these complex relationships interact in a cost effective, productive and innovative manner. Similarly, Kordana and Posner measure the optimal restructuring system as one that captures going-concern surplus value where it exists, and transfers that value to creditors in the form of equity or cash without increasing the probability of bankruptcy.

A third measure of whether the system is achieving its policy objectives is whether it is responsive to the economic and credit considerations presented by the insolvency of the corporation. A firm in financial distress may be economically efficient but in financial distress because of changing markets. In such cases, the best option may be to devise a plan that allows the firm to keep operating where there is a current or expected future market for the enterprise’s output. This may be the optimal strategy when there is no higher value use, thereby saving efficient but financially distressed firms. However, when the firm is economically inefficient and change in governance practice will not remedy its financial distress, the best outcome may be to liquidate and release the capital to higher value uses. For some scholars, the issue is exclusively one of value, whether creditors receive greater value in a restructuring than they would in liquidation, and net gain or efficiency is not part of the inquiry. Yet as the Algoma

190 Blair, supra, note 107 at 240. If the wealth captured by these groups exceeds the external costs to the corporation such as environmental liability or satisfaction of claims for harm, then the corporation is creating wealth.


192 American Law Institute, supra, note 33 at 3. The draft document suggests that these considerations are more important to successful restructuring that the legal framework in which the insolvent corporation operates.

193 White, supra, note 184 at 487-8.

194 Ibid. at 488.

195 Ibid.

Steel case discussed in chapter 5 illustrates, a firm can be inefficient and the optimal option is to continue operating but to radically change the governance practices to generate value for the firm. Thus it is important to ascertain the reasons for the corporation’s financial distress in order to best fashion and evaluate remedies.

In this respect, Triantis suggests that preserving going concern value is not in itself an adequate measure of effective restructuring because it ignores the governance role of debt.\(^{197}\) The insolvency has often signaled inefficient use of assets or managerial slack. Unless these are addressed in the restructuring decisions, going concern value will not be enhanced, the firm will ultimately fail, and costs of that failure will be borne largely by creditors.\(^{198}\) Thus, an indicium is how value has been enhanced, not just preserved, by successful implementation of a restructuring plan.

\[\text{ii. Measuring the Effectiveness of the Policy Instruments}\]

In chapter 2, I propose a series of policy instruments for achieving the objectives of an effective restructuring regime. These include, according participation and decision rights to those who have an interest in the insolvent corporation and who may have investments at risk; the expansion of fiduciary obligation that requires directors and officers to act in the best interests of the corporation having regard to all equity, debt and equitable interests; and use of existing statutory language in conjunction with a supervisory role by the courts to balance the interests of traditional creditors with those of other stakeholders.

\(^{197}\) Triantis, supra, note 1 at 102, 104.

\(^{198}\) Ibid.
Legal scholars have suggested a number of indicia for measuring the success of policy instruments. These relate primarily to cost, allocation of decision and control rights, and the need for pragmatic processes to build consensus for a restructuring plan. Franks and Torous suggest that costs of the scheme should be measured by five key criteria: whether the scheme successfully avoids premature liquidations while preventing deferred liquidations; the availability of a low-cost process for maintaining the priority of claims; confining the direct costs of the restructuring, i.e. fees of lawyers and court-appointed officers; containing the indirect costs of lost investment opportunity; and considering the costs borne by other stakeholders such as employees, customers and the state. Costs that are not part of the financial claims on the corporation in the event of default and thus are not usually taken into account in making the decision to restructure. Restructuring should be cost effective, not only in ensuring that the assets of the corporation are put to their best use, but that the administrative costs are not a bar to realizing that best use. Thus costs are an important indicator of whether the firm can be effectively restructured. To this I would add that a key indicium is whether the restructuring can be accomplished in a timely manner such that there is not further unnecessary depletion of the value owing to traditional and non-traditional creditors.

An equally important indicium is the effectiveness of the decision-making process in development of a plan and negotiation with stakeholders. Christopher Frost notes that a scheme should allocate decision-making in a way that requires decision makers to bear the costs of their decisions, and that without making such an allocation, decision-making is likely to be unaccountable and likely to fail to adequately benefit the collective

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199 In other words, restructuring should be available where the value generated by continuing the enterprise is greater than its liquidation value. The system should discourage restructuring, i.e. deferred liquidation where it is clear that the value generated by liquidation is greater than any value that will accrue from a reorganization. Julian Franks and Walter Torous, “Lessons from a Comparison of U.S. and U.K. Insolvency Codes” in Bhandari and Weiss, supra, note 88 at 450-452.

200 What they characterize as lost investment opportunity or excessive investment induced by the insolvency process, thus creating a wealth transfer, e.g. priority financing. Ibid. at 452.

201 Ibid. at 452.
Another indicator suggested by Michelle White is the ability to undertake negotiations for a workout at early sign of financial distress, whether the negotiations are private or court-supervised, because this is more likely to maximize firm value whatever the outcome of the decision.\textsuperscript{203}

The generation of wealth by the corporation is enhanced when decision-makers have an interest in the viability of the corporation. While there is considerable debate regarding who has an interest in the firm and what rights should be assigned to each class of interest, it is generally accepted that greater control and decision rights by investors, including creditors, is one factor that can enhance performance.\textsuperscript{204} This policy instrument is thus measured by both the effectiveness of decision-making by managers and by the participation and decision rights accorded to stakeholders. The issue is whether directors and officers of corporations are maximizing wealth creating potential by engaging in decision-making that takes account of the effect of those decisions on stakeholders who have contributed inputs to the enterprise.\textsuperscript{205} The extension of this reasoning is that a measure of an effective decision-making process may be that stakeholders such as trade creditors, workers and others should actually have participation and decision-making rights, particularly because they have incentives to devise viable restructuring plans. The nature of workouts and the need for high buy-in and further investment by all of the constituent groups\textsuperscript{206} will also help ensure that only proposals or plans that will generate additional value will ultimately obtain the approval of creditors, other stakeholders and the courts.

\textsuperscript{202} Christopher Frost, "Running the Asylum: Governance Problems in Bankruptcy Reorganizations" (1992) 34 Arizona Law Review 89 at 94.

\textsuperscript{203} Thus minimizing losses to creditors if the firm is ultimately liquidated. Michelle White, "The Costs of Bankruptcy: A U.S. – European Comparison" in Bhandari and Weiss, supra, note 88 at 467.

\textsuperscript{204} Blair, supra, note 107 at 240; Dallas, supra, note 158 at 5-8.

\textsuperscript{205} This is the view adopted by enterprise theorists. Blair, \textit{ibid.} at 239. For example, where there is high firm specific human capital investment, decision-making by the firm must take account of those investments in order to protect and enhance them.

\textsuperscript{206} Whether this is actual capital contribution, conversion of debt to equity, deferral of claims being satisfied or further human capital contributions, it still requires further investments by creditors and stakeholders.
Scholars have also suggested that wealth creation is enhanced when shifts in equity ownership are combined with enhanced control rights in the form of co-determination or enhanced decision-making in the firm. On approval of a restructuring plan, often the owners or investors in the firm are considerably different from pre-insolvency owners. Although some of these differences are usually reflected in the appointment of new boards of directors and a shedding of existing managers, the new directors and officers usually reflect the interests of the largest stakeholders, in other words, the secured creditors or new equity capital investors. However, if the goal is to implement creative strategies to create enhanced productivity for the firm, any revised decision and control rights ought to take account of all investments at risk in the firm. This could encompass direct control rights such as board membership, or monitoring and contingent control rights where there are mechanisms to ensure access to information, independent assessment of managerial decisions, and accountability by decision-makers.

Finally, in terms of pragmatic considerations, measuring the success of the policy instrument includes assessing the effectiveness of three distinct stages in the workout process. The first is what one restructuring expert has characterized as the "stability seeking phase" in which creditors, court officials and restructuring managers must assess the situation and determine whether there are means to stabilize the finances of the corporation. At this stage, the support of creditors is vital, and creditors require information to allow them to make informed choices about continuing to supply goods and services or extending any line of credit. Thus, effective dissemination of information is key. The second phase is the restructuring stage in which the officers of the

207 Michael Conte and Jan Svejnar, "Employee Ownership Plans" in Alan Blinder, ed., Paying for Productivity (Washington: Brookings Institute, 1990) at 143. For example, economic performance is less positive or not measurable where employee ownership or stock purchase plans in a workout are not accompanied by decision and control rights. Sarra, supra, note 27 at 29.

208 Blair, supra, note 107 at 236.

corporation and the creditors are searching for some formula that might have the possibility of restoring the viability of the corporation.210 Essential to any restructuring is building the confidence of major creditors, especially through frank acknowledgement of the extent of financial difficulties that require a remedy.211 This requires sufficient disclosure to creditors and a willingness to negotiate, having regard to the diverse interests involved.212 Stakeholders must be persuaded that there is good reason to increase their financial risk. Finally, there is what Aziz calls the execution stage in which the debtor corporation delivers a plan that can be executed and then proceeds to implement it.213 A central concern in successful restructuring is solving the problems of the enterprise in a manner that will produce the greatest benefits for the stakeholders, consistent with the rules of the insolvency system.214

The above-cited indicia are helpful in assessing the existing statutory regime, discussed in chapter 3, and in measuring the possible efficacy of the framework I set out in chapter 2. Like debt collection theorists, I conclude that an indicium of successful restructuring is that it facilitates debt collection and maximizes value for creditors while minimizing transaction costs. However, I adopt a more expansive definition of creditor against which to measure success. Moreover, given that I adopt a policy objective of enterprise value maximization in chapter 2, this cannot be the only measure of a successful scheme. Frost’s work is perhaps most helpful in that he recognizes that where there are multiple policy objectives, successful turn-around must be measured against multiple indicia including maximizing creditor recovery, preservation of human capital, equity and other

210 Ibid.


212 See my discussion in chapter 2 regarding the complex nature of creditors' interests and how they converge and diverge at this stage, infra, note 236-252.

213 Aziz, supra, note 209 at B10. Cases such as Peoples Jewellers that flip through a bankruptcy to a new company or Dylex which is successfully restored to health over time through use of the CCAA. Similar stages are described by Wilson in terms of taking corrective action in turn-arounds. Bernard Wilson, “The Creditors' and Debtors' Guide to Survival and Success” (1994), 28 C.B.R. (3d) 25, cited to insolvency.pro (Toronto: Carswell, 1999) at 26.

214 American Law Institute, supra, note 33 at 48.
investments, and maximization of going concern value where possible. Triantis’ scholarship on the governance role of debt helpfully suggests that a measure of long-term success should be governance changes that create efficiencies and enhance value. Part of that measure, however, should be whether non-traditional creditors with considerable interests in the corporation are given the opportunity to benefit from the surplus generated by both their past and future contribution to the corporation. Like Franks and Torous, I would include in my assessment of policy instruments, the costs to secured and unsecured creditors including those borne by workers, local suppliers and local governments that are not part of the fixed capital claims on the insolvent corporation. A key measure is whether the process is timely and cost effective. The challenge is to ensure that the conceptual framework clearly defines the policy objectives of restructuring, the instruments through which this can be accomplished, and the indicia by which success can be measured. This is the task I undertake in chapter 2.
CHAPTER 2

PROPOSING A CONCEPTUAL FRAMEWORK

Reconciling the Interests of Traditional Creditors, Shareholders and Other Stakeholders in the Restructuring of Insolvent Corporations

"Texture" is defined as the "character of fabric resulting from the way in which it is woven and the arrangement of constituent parts and structure".215

A more "textured" approach to insolvency law involves a clearer understanding of all the interests and investments in the firm and the way in which debt, equity and equitable interests can be interwoven to create a viable business plan for the insolvent corporation. The courts have held that the CCAA represents a "complexly interwoven...exchange of economic interests"216 and that insolvency and bankruptcy "work well into the social and economic fabric of a territory".217 Judicial interpretation has thus set the stage for an attempt to develop and clarify the relationship amongst the interwoven elements of the fabric into a more textured approach to insolvency.

In the previous chapter I canvassed some of the underlying historical purposes of Canada's restructuring regime, as well as how current theoretical debate assists in understanding the objectives and limits of insolvency law. In this chapter, I set out a conceptual framework for approaching restructuring issues building on the notions


216 Olympia and York Developments, supra, note 11 at paragraph 81.

explored in chapter 1. I propose an objective of enterprise wealth maximization and recognition of the diverse interests of all those with equity capital, debt, human capital and other investments in the corporation. Public policy is shifting towards a model that facilitates plans of arrangement or compromise. A sound systems framework is needed: to recognize the diversity of interests and to facilitate decision-making that enhances value; to measure and account for all the costs associated with restructuring or firm failure; to provide certainty to parties in their own decision-making in the process; and to encourage recognition of all those with investments at risk in the corporation.

A key systems issue is that insolvency law needs to have a more textured understanding of how the interests of stakeholders who have investments in the corporation converge and diverge depending on the circumstances. The interests of various parties with investments at risk when the corporation is insolvent are not easily categorized nor divided on a purely creditor/shareholder axis. The interests of creditors are complex and diverse, depending on the type, priority and maturity of the claim. Thus, this chapter commences with a discussion of the convergence and divergence of those interests when decisions are being made about the future of the insolvent firm. Such an understanding then assists in designing a framework that gives recognition to equitable and capital investments in the decision whether or not to restructure.

I then set out a systems approach that builds on the work of both the debt collection and enterprise theorists discussed in chapter 1. My framework has five components. There should be a policy objective of recognizing and allowing insolvent corporations the opportunity to restructure where this can be undertaken in a timely manner and where a business plan can be devised that is acceptable to all creditors. As a policy instrument for achieving this, I advocate that such a process explicitly recognize all those with investments at risk in the corporation. I discuss how this is distinguishable from a systems approach that advocates rehabilitation as the primary objective of bankruptcy law. While my view is that in a number of cases restructuring may be the optimal choice if all interests are accounted for, the policy instrument is a systems framework that
creates optimal and informed decision-making and which accounts for all of the costs of insolvency, not just those that have traditionally been accounted for.

Second, is a policy objective that recognizes workers are equitable investors in the firm such that their interests are deserving of consideration, both in the restructuring decision process and in the reorganized firm. They are uniquely situated because of their human capital investments, their reliance interest in the firm, and because of an expectation interest arising out of their human capital investment. Moreover, there is also value that workers can potentially add to the workout. The means to accomplish this is to accord workers participation and decision rights. Third, the framework must recognize that there are other stakeholders such as local governments or local trade creditors whose interests, in some circumstances, may be greater than the quantum of their fixed capital claims. Those investments reflect an interest in the future of the corporation and may be deserving of participation rights in the restructuring process.218

Fourth, decision-making regarding the future of the insolvent corporation must be undertaken with a view to maximizing the wealth of the enterprise, resulting in enhanced value for all the diverse interests, not simply those of shareholders or traditional creditors. The instrument through which to accomplish this is a recasting of fiduciary obligation to require decision-making by directors and officers in the best interests of the corporation having regard to equity, debt and equitable investments in the firm. Finally, the framework must have as an objective, recognition of the priority and value of traditional creditor rights and must require the balancing of those interests with the other interests explored in this chapter. The policy instruments through which to accomplish this are a combination of existing statutory language and a role for the judiciary in reconciling diverse interests.

218 In some cases, recognition of these interests will parallel what currently occurs with shareholder interests under the current regime. While there is no equity remaining, often their capital contribution is recognized in both negotiations for a plan and in potential value that may be ultimately accruing if the plan is successful.
A more textured understanding of the divergence and convergence of stakeholder interests is necessary to understanding any framework of restructuring. The existence of diverse creditors and other interests creates collective action problems in terms of decision-making. Thus an effective insolvency regime must assist in reconciling those diverse interests and resolving collective action problems in order to facilitate decision making regarding workouts or liquidation.

The decision as to whether a corporation should restructure, be sold to third parties as a going concern or liquidated on an asset basis is not made on the basis of a purely shareholder versus creditor assessment of interest. It is too simplistic to suggest that creditors seek liquidation and managers and shareholders want to continue the firm at all costs. Rather, given the diversity in types of credit, priority or statutory preferences, maturity, amount at risk by managers, creditors and other stakeholders, and the impact of loss of investment, the interests of all parties with investments at risk in the firm are complex, diverse and dependant on the particular fact circumstances. Thus, it is not realistic to create rigid categories of the interests that align in insolvency decision-making, because how those interests converge or diverge will depend on a number of factors. However, it is helpful to acquire a better understanding of the types of interests at stake and thus the alignments that may occur at the point of insolvency. Rather than establish broad, quantifiable categories, this understanding will help practitioners and scholars make inquiries about what considerations are most relevant in any given situation.
Stakeholders can be broadly defined as all those who have investments at risk in the firm. This definition includes traditional creditors, both secured and unsecured, shareholders, workers, managers, local governments, and possibly communities where the community will suffer some form of loss of investment on firm failure. In some cases, such as traditional creditors and shareholders, the “stake” that these parties have in the firm has been long recognized. In other cases, such as local communities, the nature of the interest requires further definition, an exercise that I undertake in part D of this chapter. How those interests converge and diverge depends on a number of legal and economic factors and this understanding is key to the governance debate.

In Canada, as in most market economies, we have a well-defined scheme of credit and an extensive legislative and regulatory scheme for the registering and enforcing of such claims. The regime also includes a series of requirements for the enforcement of credit when the firm is insolvent or moves into bankruptcy. Jackson and Scott have pointed out that any conceptualization of restructuring must recognize that the creditors’ bargain is undertaken within the system of statutory entitlements already in place. At the point of insolvency, reconciling divergent interests often requires the intervention of the court. although as discussed below, a key issue is who should hold decision-making power when parties undertake negotiations for restructuring.

Decision-making does not occur on a purely creditor/shareholder axis. Nor are tensions among traditional creditors divided as precisely as secured versus non-secured interests. There are frequently differences among secured creditors given the size and maturity of

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219 As Warren points out, restructuring proceedings increasingly deal with a myriad of social and economic problems such as mass torts, environmental disasters, and the dashed expectations of long time employees Warren, supra, note 151, at 1097.


221 Ibid. at 144.
their claims. There are numerous types of secured claims and a hierarchy based on type or order of registering the claim.

Restructuring may delay secured creditors realizing on their security, and thus, a legitimate concern of secured creditors is the possible diminution in the realizable value of assets, deferred realization of proceeds, and the use of their security by the debtor corporation to fund the negative cash flow. Thus, the willingness of secured creditors to participate in negotiations for and endorsement of a restructuring plan may depend on whether the firm's chance for successful turnaround of its affairs outweighs these possible disadvantages. They are unlikely to be willing to agree if there is a sense that the directors and officers are using the statutory scheme merely to delay an inevitable bankruptcy and liquidation. At the point of insolvency, traditional creditors are "incomplete residual owners" in the sense that there is only limited upside to restructuring, i.e. the satisfaction of existing fixed claims. Lin suggests that these creditors do not have the necessary incentive to maximize firm value, because they are only limited recipients of added value and because they wish to be paid as quickly as possible.

Secured creditors, particularly if they are likely to recover most or all of their investment, will sometimes opt for liquidation, whether sale of assets or sale on a going concern basis. There may also be advantages to secured creditors if the debtor becomes bankrupt, because in bankruptcy, provincial trust or lien claims and GST owing are generally subordinated to the status of secured creditors. For example, the banks and

222 Gary Colter, Chair, Peat, Marwick, Thorne, "Development of a New Regime for Commercial Reorganizations" (Conference on Current and Emerging Issues in Reorganizations and Restructurings, Toronto, 1991) at 2.

223 Lin, supra, note 23 at 1497. This assumes that the plan of arrangement includes no exchange of debt for equity.

224 Jackson and Scott, supra, note 220 at 144.

225 Siciliano, supra, note 21 at 8.
similar lenders often hold fixed or floating charges over a considerable portion of the assets of the corporation and may be able to recover a greater percentage of their claim if the debtor corporation is liquidated. Moreover, even if secured creditors have concluded that liquidation is not the optimal strategy, their ability to recover under such an option can give them considerable bargaining power in the negotiations for the restructuring plan.\textsuperscript{226} 

Bondholders and debenture holders often have already exercised some oversight of the corporation's activities through their loan and debenture agreements, and may conclude that it is or is not in their best interests to let existing managers or owners attempt to restructure.\textsuperscript{227} Secured creditors can also make agreements about their relative priority or about who has access to what assets or who is able to realize first in priority and subordination agreements. Given that these agreements are usually made when the corporation is solvent, the existence of these relationships may influence potential alliances among creditors.

Secured creditors have often realized that restructuring can produce better financial results.\textsuperscript{228} Moreover, some secured creditors might conclude that there are advantages to restructuring in return for a slightly better priority in terms of their claim. For example, in the recent case of Royal Oak Mines Inc., the Court indicated that creditors willing to fund debtor-in-possession (DIP) financing might be induced to lend money not only as a priority, but in exchange for acquiring enhanced priority to some of the pre-existing debt.

\textsuperscript{226} Scott has suggested that secured transactions may not be efficient because their preference on default can change pre-bankruptcy priorities and create inequitable outcomes because of their bargaining leverage. R. E. Scott, "The Truth about Secured Financing" (1997) 82 Cornell Law Review 1436 at 1462.

\textsuperscript{227} Gordon, supra, note 9 at 1477.

\textsuperscript{228} Colter, supra, note 222 at 2.
e.g. for every ten dollars of new DIP financing, one dollar of pre-existing debt would be given the same or enhanced priority.229

There are also a myriad of other types of creditors and numerous diverse interests among unsecured creditors. Unsecured creditors are the most unlikely to be paid their claims, absent some sort of statutory preference. Comparative studies in the U.K. and Germany for example, have found that at liquidation, unsecured creditors receive on average a payout of 2 to 3% of their claims.230 The Canadian experience does not appear to vary to any great extent, one study indicated that unsecured creditors had an average recovery rate of 5%.231 The size of claims may vary considerably as well as the ability to bear the losses. For example, landlords have preferred claims to rent arrears at the point of bankruptcy, and may or may not be facing repudiation of their leases in a restructuring.232

Some suppliers have limited, secured credit under existing provincial property security statutes, including use of such credit instruments as purchase money security interests.233 Given that their claims are attached to specific assets, whether their interests will converge or diverge with other stakeholders will depend on how the value of their claim may be potentially maximized. If the specific assets against which they have a claim are

\[\text{specific assets} \Rightarrow \text{potential maximization}\]

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230 White, supra, note 203 at 487.

231 This was a study of 95 Metropolitan Toronto businesses pre-1992 which measured the amount of recovery for creditors, cited in Davis and Ziegel, supra, note 25 at 7.

232 Section 136(1)(f), BIA, supra, note 5. The BIA was amended in 1992 and 1997 and codified the debtor’s ability to disclaim leases. The CCAA is silent as to whether leases can be terminated or repudiated. However, the Ontario Court in the first Eaton’s restructuring approved a plan of arrangement that allowed this over the objections of Quebec landlords who argued that the Quebec Civil Code allows for specific performance of leases and thus the landlords should have been placed in a separate class. They argued no commonality of interest, no common law doctrine of repudiation existed in Quebec and that paramountcy did not apply. The motion was never heard. In the Matter of T. Eaton Company and an application under the CCAA, Court File No. RE7483/97, C.A. Files No. M21200, M21208, Motion Record of Quebec Landlords, September 28, 1998.

233 See for example, the Personal Property Security Act, R.S.O. 1990, c. P.10 at section 33.
fungible, such creditors may be indifferent as to whether they recover through liquidation or a workout. Unpaid trade suppliers have limited remedies to recover inventory, but their recovery rights are based on strict timing and other criteria. Restructuring does not trigger their repossession rights, and the debtor corporation is free to deal with unpaid goods during the restructuring period. This is directly relevant to their consideration of whether restructuring is desirable. Moreover, even though such suppliers can apply to the court to lift the stay in order to enforce their claims on the basis of prejudice or other equitable considerations, this may still not assist where there is no bankruptcy or receivership.

Moreover, many suppliers are unable to diversify their risk because they lack sophistication in evaluating credit risks or because they are dependent on a few buyers or even a single buyer and bankruptcy would impose heavy losses for unpaid supplies. Those debtor corporations that have small borrowing bases, such as perishable goods, software or research and development have primary assets that have little value in liquidation. Such firms often rely more on trade credit than banks or other institutional lenders, and their ability to successfully negotiate a workout depends on continued supply of that credit. Even for more sophisticated suppliers, Wilson has pointed out that assisting a customer in a workout may be more valuable and less costly than acquiring new customers. Thus the interests of trade suppliers and the debtor

234 Section 81.1, BIA, supra, note 5 sets out the rights of unpaid suppliers to repossess goods. For example, there is a limited window in which unpaid suppliers can repossess goods within 30 days of delivery in event of bankruptcy or receivership, if the demand is made in writing, the goods are possession of the trustee and are identifiable and in the same state when delivered. Once the right to repossess is consented the supplier has ten days to repossess at its own expense. Siciliano, supra, note 21 at 15-16.


236 Colter, ibid. at 14.

237 Ziegel and Davis, supra, note 25 at 11, citing Re Woodwards Ltd. and Consumers' Distributing cases.

238 Ziegel and Davis in discussing whether to grant super-priority to suppliers raise the issue of whether such priority would reduce the availability of financing to small and medium size firms, ibid. at 21, 29.

239 Wilson, supra, note 213 at 25.
corporation may converge if it appears that amiable terms of credit during and after the restructuring period can be worked out.

While trade suppliers are not required to advance further credit during the restructuring process, they may determine that it is in their long-term interests to do so because it may increase the likelihood that some portion of their prior claim will be recovered. Since they are able to require that any further supplies are undertaken on a cash-on-delivery basis, they may not be concerned about having to follow normal commercial practices thereby placing an even greater amount of their capital at risk. Suppliers may decide that they have more to gain from future business with the debtor corporation and thus may be willing to agree to a plan of arrangement or compromise. Suppliers, franchisers and licensors often face contractual arrangements which specify that termination is permitted on commencement of insolvency, and these parties may be concerned about the loss of goodwill if they are not able to arrive at a restructuring agreement acceptable to the majority of creditors.

In each of these cases, depending on the facts, the interests of unsecured creditors may or may not converge with secured creditors, shareholders or other stakeholders. One might be tempted to conclude that since unsecured creditors are likely to receive little if anything out of liquidation, they are more likely to be interested in a restructuring plan in the hope that some value may be generated and some of their claims will be repaid. Yet it is important to be careful about this generalization. If the restructuring is unlikely to increase the probability of recovery or does not increase the amount of recovery for unsecured creditors, they are unlikely to support the plan.240 For example, there are creditors who are given particular statutory rights to enforce claims under such statutes such as the Repair and Storage Liens Act and the Miners' Lien Act.241 An Ontario court

240 Lin, supra, note 23 at 1495.

recently determined that the claims of lien holders under particular lien holders' statutes operate in such a manner as to limit the inherent jurisdiction of the court to grant a super-priority of DIP financing during a CCAA application.\textsuperscript{242} Thus while lien claimants are stayed during the CCAA period unless the court has lifted the stay, ultimately such claims cannot be subordinated by DIP lenders without the consent of the lien claimants and cannot be overridden by the court in endorsing a motion for priority financing for the restructuring.\textsuperscript{243} For certain statutory lien claimants, the effect of bankruptcy can be to reverse the priority of claims because the scheme for distribution in bankruptcy prevails.\textsuperscript{244} Thus, the statutory restrictions may result in the interests of these claimants diverging from those of other creditors.

The diverse interests among unsecured creditors may also depend on other statutory preferences. For example, taxing authorities have particular rights that differ in and outside of bankruptcy. The wage and vacation claims of workers are given preference in bankruptcy, yet are subject to other statutory preferences outside of bankruptcy. Notwithstanding remedies for their fixed claims, workers may have an interest in keeping the firm going to protect jobs, pensions and human capital investments. However, that interest may be indifferent as to whether the workers themselves purchase an interest or the firm is sold on a going concern basis to a third party where the option includes job preservation and protection of benefits. Where third party sale or restructuring entails labour downsizing and loss of their human capital investments, workers' interests are unlikely to align with those seeking the sale or restructuring. Plans or proposals that do recognize an equity or human capital investment by workers may be purely transitional or may be the result of negotiations for an alteration in governance structure.\textsuperscript{245} Under each


\textsuperscript{243} Ibid.

\textsuperscript{244} Construction lien claimants do not fit in the category of those who can be subordinated. They are in effect secured creditors for part of their debt. Geoffrey Morawetz, interview (23 July 1999). Section 136, BIA, supra, note 5.

\textsuperscript{245} The worker buyout of Abitibi Paper was a good example of a purely transitional restructuring. The Union involved was not particularly sympathetic to workers investing further human capital in the form of
of these possible outcomes, workers' interests may align with a variety of creditors, shareholders and other stakeholders.

This may also be the case in an asset sale where the new buyer plans to retain skilled workers. The sale of assets in the *Red Cross* case discussed in chapter 7 is a good example of this. In the case of highly specialized skills, the interests of the creditors, shareholders and workers may converge because it is in the interests of all parties to retain the skills to maximize the value of the restructuring or a going concern sale. In cases where workers' human capital investments are more generalized, as opposed to firm specific, it is less likely that shareholders, managers and traditional creditors will recognize a convergence of interest with employees.

The *BIA* sets out the priority of payments to preferred, secured and unsecured creditors in the case of bankruptcy and these in turn influence determination of where interests align in the restructuring decision. These statutory preferences influence the environment in which creditors and managers bargain, and strict priorities and *pro rata* sharing might be compromised. The tax implications are also highly relevant. The scheme of the *Income Tax Act* generally reflects that of the *BIA* and *CCAA* in that there is public policy recognition of the value of restructuring. Thus, the tax benefits accruing to a restructuring are aimed at facilitating a workout and may also influence where interests align.

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246 Section 136, *BIA*, supra, note 5. Preferred creditors include funeral expenses, costs of trustees and legal fees, levies payable to Superintendent of Bankruptcy, employee's wages and expenses to a maximum, municipal taxes, landlord's rent arrears, costs of first execution creditors. Siciliano, *supra*, note 21 at Appendix S3-C.


There may be a convergence of interests where a number of creditors have high probability of recouping some value if the corporation is reorganized. Institutional lenders or venture capital funds may be willing to endorse restructuring where it is accompanied by internal governance changes. Institutional investors, including pension funds, currently own more than 35% of outstanding shares in publicly traded Canadian corporations. The amount of investment combined with fairly rigid domestic and foreign investment rules means that such investors cannot easily liquidate their holdings if unhappy with the performance of the corporation. Increasingly, therefore, these investors are looking toward restructuring as a means of recouping losses. They have the resources to actively participate in the negotiations for a restructuring and to insist on governance changes as a condition of their support.

There are also considerations beyond those that are purely commercial that touch on the creditor's relationship to the social and political environment in which it operates. One experienced insolvency practitioner has noted that parties involved in restructuring exercises seldom want a non-survival solution. For example, banks may be reluctant, particularly in smaller communities or northern communities, to be seen as the party that "pulls the plug" on the firm. Banks view the members of such communities as current and future debtors, and may not be willing to risk the loss of goodwill.

Bankruptcy and insolvency law recognizes tort, environmental and other liabilities, and the parties that seek redress or enforcement may or may not converge in their interest in restructuring the corporation. Those with tort claims do not usually have investments


250 Colter, supra, note 222 at 2.

251 Warren, supra, note 151 at 880. For example, in Royal Oak Mines, several First Nations Bands alleged that the B.C. Government had violated their rights by failing to consult with the Bands before granting licenses and permits to the Kemess Mine. See Tsay Key Dene and Takla Indian Bands v. Kemess Mines
in the firm. Rather they have a claim against the assets of the firm based on the past conduct of the officers or agents of the corporation. Thus they may not have an interest in survival of the firm. For example, if injuries have already manifested themselves, tort claimants might well advocate liquidation as a ready means of acquiring access to cash settlement of claims. This is particularly the case if time is of the essence because of the nature of the harm. If they are unmanifested tort claims, such as asbestos victims whose tort may be based on past completed actions but for whom there is a long latency period before the harm will be discernable, they may have an interest in seeing the corporation successfully restructure and continue to try to generate value for the settlement of future claims. Moreover, if there are other possible avenues of settlement of claims, such as discussed in chapter 7 in the Red Cross case, it may be in the interests of tort claimants to use the voting rights under restructuring legislation as a negotiating tool to attempt to bargain a better settlement outside of insolvency proceedings.

The assessment of whether going concern value is worth more than liquidation is also likely to influence the decision of parties regarding restructuring. These values are often difficult to quantify. The question is whether the long-term prospects of the firm are better than the short-term value of liquidation. Liquidation often means large financial losses for various groups of creditors, loss of employment, negative implications for the economic fabric of the community, and costly litigation in determining priority and enforcement entitlements. Similarly, assessments by stakeholders of the feasibility of restructuring, the time and cost of restructuring, and assessment of the risk of firm failure will be important considerations in how interests converge. Assessment of the likelihood of sufficient numbers of creditors agreeing, assessment of the future of the particular industry, the integrity and skills of managers, the skills of workers, the availability of

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252 *Jackson,* supra, note 129 at 63.

253 *Jackson and Scott,* supra, note 220 at 144.

254 *Colter,* *supra,* note 222 at 2.
additional financing and possibility of future profitability are all considerations of stakeholders. They are determinants not only of how interests will tend to converge or diverge, but also generally of the likelihood of successful adoption and implementation of a restructuring plan or proposal.

The role of managers and how they perceive their interests to converge or diverge is also key, particularly in the initial stages of a restructuring application. Where the directors and officers hold considerable amounts of equity, these interests are likely to highly converge with other shareholders and there may be problems in how they identify their interests with creditors. However, for publicly traded companies, where managers are concerned about reputation, future job prospects and avoiding liquidation, they may identify greater interest in building alliances with institutional and trade creditors and thus play a key role in identifying where interests converge. Given that they often have important informational capital and experience with day to day operations, creditors may understand the value in keeping managers in place at least for some period.255 However, studies in Canada and the United States have indicated that the vast majority of managers are replaced either during or shortly after the restructuring process and this may affect how they perceive their role in the process.256 Susan Rose-Ackerman points out that the independent role of managers is often neglected in the consideration of conflicts of interest between shareholders and creditors.257 Given that managers will try to avoid liquidation, she suggests that it is not clear that managers will always engage in excessive risk taking during insolvency, that this is only one possible outcome.258 Where managers act cautiously to avoid liquidation because they have determined that it is in their

255 Frost, supra, note 202 at 90.


257 Ibid.

258 Ibid. at 284.
interests to do so, there may be great potential for a convergence of their interests with those of creditors.\textsuperscript{259}

Where shareholders are also directors or officers of the corporation, personal liabilities for employee wages and other entitlements or environmental harm may determine how their interests align. Where there is considerable personal liability, these officers may work to delay reorganization or bankruptcy until they have taken steps to reduce their personal exposure, such as ensuring money owed under statutory preferences are paid or a trust is created to cover any liability. For closely held corporations, the corporate veil may not be sufficient to protect active operators from personal liability. Moreover, those parties may be personal guarantors of particular debt, which secured creditors will pursue if there is not some agreement on restructuring. Recent amendments to insolvency law now allow for a compromise of claims against directors related to obligations of the corporation for which they are vicariously liable.\textsuperscript{260} Thus directors now have incentive to negotiate a successful proposal to gain immunity from these liabilities where they are able to persuade creditors.

Similarly, the interests of shareholders may or may not converge with creditors or other stakeholders. Where firms are closely held, there may be longstanding relationships with communities, workers, and creditors. There is also likely to be a strong desire to retain control of the company. Where shareholders are widely dispersed, they have the same collective action problems as they do in the solvent corporation. They may have diversified their risk such that it is most cost effective to take the loss rather than to expend any energy in an effort to support revival of the corporation. Shareholders may be more willing to accept high risk decisions as the firm approaches or becomes insolvent because they have everything to gain and little or nothing to lose. This directly conflicts with creditors who want conservative fiscal management in order to preserve any value

\textsuperscript{259} Ibid. at 293.

\textsuperscript{260} Section 30(6), CCAA, supra, note 5. See also section 50(13), BIA, supra, note 5.
remaining in the assets in order to satisfy their claims. Shareholders receive little or nothing in the liquidation of an insolvent firm, thus it is often in their interests to encourage restructuring because they incur no further losses because of their limited liability. However, depending on how shareholders view the reallocation of equity on a restructuring, their interests may converge or diverge from those of senior creditors in terms of endorsement of a particular plan or proposal.

Given these diverse interests, for the debtor corporation seeking to restructure, it is important to determine who has the key bargaining power. Senior secured creditors have long been recognized as key participants, but there may be others whose interests converge and who are key contributors to the potential turn-around. As is discussed in the next part, this may involve recognizing the value of human capital contributions or the requirement to negotiate arrangements with local tax or environmental authorities.

Jackson and Scott point out that compromises are inevitable to preserve the efficiencies of the collective action regime, and that such compromises are tolerated because the aim is to maximize value for the group. Any distributional effects should be understood in this light. They suggest that the case for restructuring is bolstered if one recognizes the multi-relational and complex risk-sharing arrangements among employees, trade suppliers, unions and other parties. If such interests bring a synergistic effect to the firm, it may be cost efficient to negotiate an arrangement acceptable to all affected.

The divergence and convergence of interests and diversity of claims to the firm's assets are key to understanding a successful restructuring regime. Yet in Canada, the shift from

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261 Lin, supra, note 23 at 1487.
262 Jackson and Scott, supra, note 220 at 146.
263 Ibid. at 158.
264 Ibid. at 158.
the paramountcy of shareholder-centred governance for the solvent firm to creditor-centred governance during the period of insolvency fails to fully explain or help define who should have voice and control rights in this exercise. Some parties with investments at risk in the corporation should be accorded a greater decision-making role than that which would be apparent from the quantum of their fixed claims. While my conceptual framework set out below endorses the notion that the rights of traditional creditors should be protected in restructuring proceedings, I suggest that the public policy reasons for suspending enforcement rights during stay periods are the same public policy reasons for redefining decision rights during restructuring negotiations. The balancing of traditional creditor rights with other stakeholder interests is the central challenge of such an approach.

Key to my systems framework is endorsement of the value of a scheme in which insolvent corporations are given the opportunity to work out their affairs. I suggest that the stakeholders themselves, with the assistance of the court-supervised process where necessary, are in the best position to negotiate and agree on a value maximizing strategy.

B. Public Policy Recognition of the Value of Workout Schemes

The first component of a framework for the governance of insolvent corporations is endorsement of current public policy that recognizes workout regimes as valuable

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265 In this, I separate the interests of workers from other stakeholders because of where they are uniquely situated in the corporation. I then discuss how other stakeholders may be deserving of recognition of their interest in the corporation, through the allocation of participation and decision rights in the formulation of restructuring plans.

266 Stakeholders here refer to the broad definition above, including shareholders, traditional creditors, workers and others.
mechanisms. The policy objective is that companies experiencing financial difficulty should be given an opportunity to restructure their affairs to remain operating if it appears that a viable business plan can be developed that will be acceptable to creditors. A central purpose of insolvency legislative reform in the 1990's was to facilitate the ability of insolvent corporations to develop plans or proposals, to allow them to negotiate and build consensus and support among creditors, and to ensure that such a process is undertaken in a timely and cost effective manner.

The difficulty with the market theories discussed in chapter 1 is that private workouts generally occur only when the corporation is small, its ownership structure simple, the creditors relatively few in number, and the type of debt uncomplicated. Yet the economic reality of firm insolvency today is there are multiple creditors, a complex array of debt instruments and arrangements, multiple classes of shares with different powers and payment obligations, numerous international credit arrangements, resulting in a huge diversity of claims to the corporation's assets. Thus, private workouts are in many cases difficult to accomplish. During negotiations for a private workout, the debtor corporation is unable to prevent the creditors from taking unilateral action to enforce claims before it can negotiate a workout acceptable to all creditors. Hence the need for the protective mechanisms under restructuring statutes. The assistance of a court-imposed stay creates breathing space for the corporation to try to devise a survival strategy and to persuade creditors of its merit. Thus, the current regime grew out of the necessity of having an orderly scheme for the negotiation, endorsement and sanctioning of restructuring plans. As was noted in the introduction, the sheer volume of debt and the number of well-known corporate failures have resulted in a renaissance in the use of insolvency law to restructure the affairs of Canadian corporations.

The insolvency regime has developed an understanding of what forces are at play when a corporation is insolvent. As noted above, whereas with the solvent corporation the objective of decision making is to maximize shareholder wealth, when the corporation becomes insolvent, there is little if any equity value remaining for shareholders. Thus, the operating normative paradigm during insolvency is that decision-making should be
taken with regard to the interests of traditional creditors in order to maximize the value of their claims. This often creates a conflict of interest for managers because their loyalties have previously been almost exclusively to shareholders.²⁶⁷

Given the statutory hierarchy of claims, in reality, creditor value maximization has often meant decision-making in the interests of secured creditors, since the highly leveraged nature of most insolvent firms leaves little to satisfy the claims of unsecured creditors. Unsecured creditors also often do not have the information or resources to participate in workouts other than consideration of a proposed compromise of their specific claims. Moreover, since workouts are dependent on the support of the secured creditors, decision-making is most often geared to maximizing the value of their claims. There are important public policy reasons for this weighting in favour of secured creditors, which have largely to do with the importance of having cost effective credit available to businesses and the risk of losing that availability if that debt is not enforceable.

The theoretical underpinnings of Canada’s insolvency and bankruptcy legislation are that it is necessary to protect and encourage credit as a means to encourage entrepreneurial activity and generate wealth creation. The system is premised on the assumption that credit can be enforced, particularly when the corporation is experiencing financial difficulty. There is a hierarchy of claims and an elaborate framework in which to enforce it. Black points out that creditors exercise “default rights” that include the ability to demand early repayment if the debtor corporation violates debt covenants, as well as “non-payment rights” in which creditors can force the debtor corporation into bankruptcy.²⁶⁸ A counter-balance to the system of debt enforcement is the public policy recognition that firm failure results in severe economic hardship for numerous stakeholders. Creditors lose their investment, particularly unsecured creditors who are at

²⁶⁷ Which may explain why directors and officers are frequently replaced immediately after the restructuring plan is approved.

²⁶⁸ Black, supra, note 181 at 6, 7. He notes that some creditors have both kinds of control rights, and some creditors, just the latter type.
the bottom of the hierarchy of claims satisfaction; governments often lose tax revenues and have the added social and economic costs of paying for employment insurance and welfare assistance; and workers are often unable to find secure employment at comparable wages. Thus, the policy objective of encouraging restructuring is accompanied by a series of instruments, such as stay provisions that allow parties to determine whether these losses can be mitigated through a proposal or plan of compromise or arrangement. It is premised on the belief that firms are often worth more as a going concern than their assets are worth on a liquidated basis. Accordingly, there is merit in statutory schemes that facilitate restructuring.

Insolvency can be the product of efficient governance that is overcome by competitive markets and variations in foreign exchange. Thus firms may be in financial distress notwithstanding their governance practices. However, insolvency can also be the product of inefficient decision-making or excessively high-leverage financing, and thus managers’ practices have precipitated the problems. In such cases, restructuring as an option may only be realistic with a major overhaul of debt structure and/or governance practices. Workout regimes allow parties to ascertain the likely cause of the financial distress. This is key to the development of a viable business plan and determination of an optimal strategy for the future of the insolvent corporation.

Restructuring law offers an alternative to a strict liquidation scheme in which creditors try to maximize their proceeds from a sale, whether on an asset or going concern basis. The premise of the scheme is that while it is a creditor process, there is a balancing of interests in terms of creditors and any residual rights held by shareholders.²⁶⁹ Canadian insolvency law has recognized that while there is value in a corporation trying to restructure in order to help the firm become viable again, ultimately creditors have the right to enforce their claims.²⁷⁰ Hence, the statutory provisions for protection of the court

²⁶⁹ Residual rights in this sense may not be capital claims, because there may be no equity remaining in the firm. However, shareholders have made a capital contribution to the firm and may be deserving of some part of the future value that may be generated in a turn-around.

²⁷⁰ See Anvil Range Mining Corporation, infra, chapter 6.
and a stay of proceedings to allow the debtor corporation to propose a viable plan are only a temporary suspension of creditors' rights to enforce.

The second aspect of public policy recognition of the value of workouts is that the debtor corporation in most cases retains control of the business during the stay period pending development of a plan. The premise is that existing managers have the informational capital that is required to develop an effective plan. However, decision-making by the debtor corporation is circumscribed in a number of ways during this period. While the scheme does not go as far as the U.S. regime in terms of a concept of "debtor in possession" which is operating the corporation in trust for the creditors, directors and officers do acquire a fiduciary obligation that encompasses an obligation to creditors. Court-appointed officers monitor and report to creditors and the court on the corporation's activities and cash flow. As will be discussed in chapter 3, numerous features of the system such as short stay periods, frequent reporting, and comeback clauses for creditors to bring matters to the court, protect creditors' interests during this period, and offer a balancing of interests between shareholders and creditors. These policy instruments are integral to the scheme.

Also key is the role of the judiciary as both mediator and arbiter of diverse interests of parties. As will be evident in the discussion in chapter 3, under the BIA, this role is largely a rule driven statutorily mandated one, and under the CCAA, the court has broad discretion to balance the competing interests during insolvency proceedings. The court has utilized this discretion to promote the public policy objective of restructuring. Jackson and Scott have pointed out that one of the key benefits of a court-supervised process is that it creates a cost effective forum in which multi-relational and complex risk

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271 See discussion, infra, chapter 9.

272 For a discussion of the role of monitors and trustees under the CCAA and proposal parts of the BIA respectively, see discussion in chapter 3, infra, at note 690.

273 Creditors can argue before the court that the actions of the debtor are prejudicing or unnecessarily depleting their interest. They can also allege bad faith or other inappropriate conduct by the debtor.
sharing arrangements can be reconciled and aimed at finding an optimal restructuring arrangement. Thus, judicial oversight is a key instrument that assists with the reconciliation of divergent interests in insolvency and with promotion of the policy objectives of satisfying creditor claims and facilitating workouts.

The current policy objective of giving corporations an opportunity to successfully restructure their affairs has not usually been accompanied by participation and decision rights for all those with an interest in the insolvent corporation. Only infrequently in such processes has there been a voice or active participation by stakeholders such as workers, communities, local governments, and contingent creditors such as tort claimants. There are two types of interests held by these stakeholders. The first are those capital claims already recognized by the law and the courts, such as claims for wages, vacation pay, tax arrears, orders for environmental clean-up and damages for tort. Although these stakeholders are traditional creditors in terms of their capital claims, they have historically not had the information or resources to participate in insolvency proceedings. The second type of stakeholder claim involves those interests that are not fixed capital claims, but which reflect interests at risk if the corporation fails. These include loss of firm specific human capital investments; the costs of environmental harm to future land use and local community dependence on effective use of that land; and costs to trade creditors and local economies from lost merchant trade. This type of interest has not been formally recognized historically, although courts make reference to these interests under broad notions of the “public interest”. The scheme has focused on traditional creditors, who have claims ranking in priority over interests of shareholders, and who obtain the right to insist that decision-making in the corporation shift toward their interests. The paradigm still operates to recognize only those stakeholders who have

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274 Jackson and Scott, supra, note 220 at 158.

275 See discussion, infra, note 442, regarding the appropriate role of judicial decision making in this framework.


277 If not, those interests will be realized through liquidation of the firm and distribution of the value of the assets.
capital invested in the firm, in the form of equity or debt. Other forms of capital, such as human capital, do not enter the equation, unless, as I discuss below, they are necessary in terms of extracting concessions in order to assist the firm in surviving.

Debt collection theorists argue that employment and rehabilitation objectives have no place in bankruptcy law because they would disrupt pre-bankruptcy entitlements and detract from the core function of the statutory scheme as a debt-collection device. Their analysis focuses on the “owners” of the corporation’s assets. Jackson asserts, for example, that for the insolvent corporation the "owners" are the creditors and the only justification for restructuring is that the reorganized firm is better for its owners than alternative uses of the assets. In reality, neither shareholders nor creditors are “owners” of the assets, rather they have a residual claim to the proportional value of the assets. This pure ownership approach ignores other economic investments and interests at risk, such as workers’ human capital and investments by communities in the infrastructure that supports the local enterprise.

The attempt by Canadian law to recognize the “public interest” in restructuring proceedings is an attempt to recognize the social and economic consequences of any decisions taken, while still recognizing the importance of traditional creditors and the continued availability of capital financing. Thus, public policy recognition of the value of workouts reflects the objective of assisting firms to devise a strategy to satisfy their creditors while remaining in operation. It is a balancing of interests rather than pursuit of a solitary objective of corporate rehabilitation. The issue is not whether to take

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278 Jackson argues that there are two distinct steps whether the outcome is liquidation or reorganization. First is the sale of the assets, and second, the claims against the debtor corporation are paid out of the sale proceeds. Jackson, supra, note 129 at 210, 211.

279 Ibid. at 210.

280 The debt collection theory is not a balancing of interests either, and thus is not reflective of the policy objective underlying the restructuring regime in Canada.
account of the "public interest", but rather what is the proper balancing of interest between traditional creditors and other interests.\textsuperscript{281}

The Canadian regime takes account of creditor interests almost purely on the basis of the nature and quantum of their claims to the value of the residual assets of the corporation.\textsuperscript{282} Thus, workers as fixed claimants have some rights to participate in the scheme. However, that participation has been severely limited because of the proportionally small amount of their fixed claims, and because of lack of information and resources to fully participate. I suggest that in reality, workers are uniquely situated as human capital investors, and that their risk of loss on firm failure is substantially higher than the value of their fixed claims. Thus, the second component of my framework is adopting a policy objective that explicitly recognizes workers' equitable investments and interest in the insolvent corporation. As the instrument to achieve that objective, workers should be accorded an enhanced role in the governance of insolvent corporations. Implicit in the following discussion is an attempt to discern who is or should be governing the insolvent corporation during the negotiations for a workout, who should be present at the negotiating table, and who should have decision rights in the ultimate outcome.

\textit{C. Workers as Equitable Investors Should be Afforded an Enhanced Decision Making Role in the Negotiations for a Restructured Corporation}

Statutory standards or national insurance programs may be the optimal means of protecting workers' human capital investments in the firm in terms of their fixed claims.

\textsuperscript{281} Tilting the balance too much towards other interests or the "public interest" will lead to premature liquidations by traditional creditors. However, the problem is that at present the balance is tilted away from these other interests.

\textsuperscript{282} Jackson and Baird would endorse this, see supra, note 103.
Equally, such schemes could be designed to recognize claims beyond fixed capital claims by creating comprehensive retraining programs and other schemes that assist with adjustment harms. However, with the current dismantling of statutory protection, it is unlikely that in the near future the investments of workers will be protected through this means. The question therefore is whether there is a mechanism within existing insolvency law that will recognize those investments and give workers access to a proportional share of the value of the insolvent corporation's assets, in the same manner that the law works to protect traditional creditors' investments now.

In this part, I suggest that workers' human capital investments run along a continuum of fixed and residual claims and that it is important to assign a value to those claims. I explore why traditional contract theory and implicit contract theory are not sufficient to protect the value of those investments. I suggest means by which these claims could be quantitatively valued. Once valued, there are several outcomes. Fiduciary duty would be recast to require directors or interim receivers to make decisions in the best interests of the corporation having regard for the human capital investments in the firm as well as equity investments. Second, the value of the claims should afford workers participation and decision rights in the workout process. Third, workers could then agree to arrangements or compromises that protect their investments. Finally, in addition to satisfying their claims, workers may be able to contribute informational and organizational capital that will enhance decision making in the restructuring process.

A substantive objective of the Canadian insolvency scheme is currently to provide corporations the opportunity to develop a viable business plan that is acceptable to creditors. Creditors are a defined term in the legislation.283 The definition of creditor for purposes of insolvency law includes workers to whom wages and benefits are owed. Depending on the nature of the claim, workers are either statutory preferred creditors or unsecured creditors or both. They and their unions may also be creditors in the sense of contractual obligations under collective agreements for which the debtor corporation is responsible. Moreover, trade unions may be unsecured or preferred creditors in terms of

283 Section 2, BIA, supra, note 5; section 2, CCAA, supra, note 5.
amounts owing in union dues deductions or remittances to pension plans and/or health and welfare plans. Although insolvency law recognizes workers as residual claimants in a way in which governance theory regarding solvent corporations has not, the nature of these residual claims is still narrowly defined as the fixed capital claims arising out of employment contracts and statutory benefits.

The interest of workers, however, extends beyond their fixed capital claims and I suggest that it is this interest that needs to be more explicitly recognized in insolvency law. First, it is important to understand the nature of that interest. Human capital investments in the firm vary considerably. For example, the investment can be in the nature of a reliance interest. The worker contributes her or his labour over an extended period with the expectation that the value of her or his interest will increase over time. The worker may forego other employment (investment) opportunities in reliance on these interests. This reliance interest is not adequately protected by employment contracts or statutory provisions for termination and severance because those are aimed solely at fixed claims.

Second, there is an expectation interest. In making contributions of human capital, workers, even contingent and secondary labour market workers, have an expectation that they will do well if the firm does well and this creates an incentive to make contributions to the firm that have value greater than that compensated for by wages and benefits. Workers have a reasonable expectation that these investments will be protected and if they have made human capital or other contributions, they will be valued by the firm. In the insolvency context, this expectation interest may translate into claims for a proportional share of the value generated by any successful turnaround.

Moreover, workers as human capital investors, just as shareholders as equity investors, have difficulty making complete contracts. Private contracts have proven insufficient to protect workers' interests because of information asymmetries and because workers rarely have the bargaining power to negotiate contracts that adequately protect their interests. Unlike a contractual relationship with institutional creditors, parties to the employment contract, whether it is an express or implicit contract, are often contracting
for an unspecified period of time and unfixed quantities and quality of labour. Workers have reasonable expectations that they will do well if the firm does well. Workers rarely view the compensation package as compensation for risk of firm failure, and rarely are they able to negotiate terms of employment that account for the risk of firm insolvency where they have recognized their reliance interest. One of the reasons that workers join unions, for example, is that they have been unable to bargain for decent wages and working conditions in the absence of some collective action mechanism. Contracting at the outset of the employment relationship for risk of unemployment is a rare exception, usually found where workers' skills are so specialized and in short supply that they have the bargaining power to demand a wage premium. While unionization has resulted in marginally greater protection for workers in terms of the solvent firm, generally unions have been unable to bargain for protection against the risk of firm failure, other than some small provision for termination and severance.

Traditional contract theory makes four assumptions: that parties had full information at the time of the contract such that they can contract against a variety of foreseeable future risks; that if harm is not specifically provided for in the contract, it represents a decision by parties in terms of risk assumption and compensation for that risk factored into the contract; it assumes that parties understand that fiduciary duties flow exclusively to equity holders and that the contract does not rely on that duty to fill gaps in the contract; and finally that government intervention will distort optimal private bargaining. If one considers a traditional creditor such as bank, these assumptions of contract theory make sense. The bank requires full disclosure before it advances credit and it factors the risk of firm failure into the amount, type and terms of credit. The bank understands that fiduciary obligation flows exclusively to the corporation, usually defined as shareholder value maximization, and thus does not rely on such a duty to fill gaps in the contract.

However, when the corporation becomes insolvent, banks have successfully argued that

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284 Sarra, supra, note 27 at 58.

285 Contracting for the retention of the skills of key employees during the restructuring process is a good example of this rare situation.
fiduciary obligation will now flow to creditors as residual claimants. Finally, government intervention does little to aid optimal private bargaining given the above factors and the high dependence of corporations on available and cost effective credit.

The same assumptions of contract theory do not apply to employment contracts. The majority of Canadian workers do not have formal employment contracts and only 37% of workers are covered by collective agreements. Thus the majority of Canadian workers are not able to bargain collectively for compensation to reflect the value of their human capital investments, nor protection against future adjustment harms. Workers and unions face serious information asymmetries such that they cannot contract for foreseeable risk. This is exacerbated by residual management rights theory and labour laws that do not require full disclosure. Unlike the example of the bank, workers and unions do not have the bargaining power to insist on this disclosure prior to making employment contracts.

With current labour markets, it is also difficult to contract for potential harm to workers. Negotiated severance pay is only small protection against the loss of human capital investment. Even if unions try to bargain against “future categories of risk” such as firm failure, they do not have the bargaining power to secure such contractual protection. Thus the risk of firm failure is not accounted for in the contract in terms of adjustment compensation, retraining, relocation assistance or other mechanisms to protect human capital investments. Moreover, workers are generally not sophisticated enough to understand that fiduciary obligation will flow directly to shareholders and thus cannot be relied on to fill gaps in employment contracts. Finally, for the above reasons, workers do not assume that government intervention will distort private optimal bargaining. In fact,


[287] Katherine Swinton, “Comment on Labour Participation in Workplace Governance” (1993) U. T. L. J. 793 at 793. Unions are particularly strong in the resource industries, large secondary manufacturing and the public sector. For the vast majority of other workers, they do not have the protection of collective agreements and current labour laws make it difficult to organize unions.

It has been government intervention that has historically enhanced bargaining in the case of workers, just as it has engaged the interests of shareholders under securities legislation.

There is another way in which employment contracts differ from those of other creditors. On insolvency, the debtor corporation must bargain to retain supply contracts because preservation of the value of such contracts may be key to the corporation’s survival.289 Thus, there is some incentive to negotiate the terms of continued credit in order to induce the creditor to continue granting credit in the form of financing or trade supplies during the period in which the corporation is trying to devise an acceptable business plan. In turn, such creditors can insist on disclosure in order to make an assessment of whether to continue extending credit during or after the restructuring application process. Collective agreements differ in that, during the restructuring decision-making process, workers are not able to collectively withdraw their further investment of human capital because Canadian labour laws prohibit work stoppage during the life of a collective agreement.290 Thus there is not the same incentive for early disclosure or negotiation by the debtor corporation. Given that there is no right for unions to renegotiate the terms of the collective agreement during the life of that agreement, restructuring decisions during periods in between collective agreement negotiations do not require the corporation to negotiate with the union for protection against adjustment harms.291

Moreover, implicit contract theory, which suggests that workers bear residual risks and are unable to foresee and thus adequately contract for risk of firm failure, does not provide an adequate answer to the loss of workers’ human capital investments. These


291 Trebilcock and Howse point out that workers are unable to extract compensation for post-contractual decisions that harm their human capital investments, even if this decision making is opportunistic and that this thus encourages expropriation of workers’ investments. Michael Trebilcock and Robert Howse, "Protecting the Employment Bargain" (1993) 43 U. T. L. J. 751 at 761, 764. The debtor corporation does not perceive disclosure and bargaining rights on its priority list in terms of lining up support for its plan given the proportionately small amount of workers’ fixed capital claims and the fact that on bankruptcy, if it occurs, workers will have no employment contract.
theorists argue for importation of notions of implicit contract enforcement based on parties’ actual expectations in terms of firm specific human capital investment and deferral by workers of payment in exchange for job security. While the value of these theories is the recognition that human capital investments should somehow afford workers remedies upon loss of that investment, it is unclear whether this is adequate protection. The premise of implicit contract theory is that on firm failure, managers are unlikely to harm employees because of loss of their reputational capital and resultant depreciation in overall value of organizational capital. However, given my discussion above regarding managers’ interests during this period, it is unclear that creditors or shareholders would either be aware of managers’ breaches of implicit contracts or that they would necessarily recognize an interest in enforcing those contracts. The exception might be those cases where the skills are so specialized that it is in the interests of the debtor corporation and the creditors to retain the skills of the workers. However, absent this situation, workers who have made an investment in the firm of a reliance nature are unlikely to have a remedy.

Implicit contract theory is also premised on the notion that workers are aware of breaches of implicit contracts and thus will withdraw their labour or refuse to contribute their labour where managers have reputations of failing to comply with implicit contracts. Again, this ignores information asymmetries, lack of bargaining power, statutory prohibitions on the withdrawal of labour, the limited employment choices and inability of workers to easily relocate away from their community, the growth of a contingent labour force, and the entire issue of who currently has decision and control rights during the

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293 Daniels, ibid. at 338.

294 For a full discussion of why implicit contract theory will not adequately protect workers’ human capital investments, see Sarra, supra, note 27 at 63 to 67.
period of negotiations for a workout. Moreover, the difficulty with implicit contract enforcement is that scholars argue that it would be enforced to the degree contemplated by the parties in accordance with their intentions. Yet little attention is given by implicit contract theorists as to how differences in intent would be reconciled in finding the actual substance of implicit contracts. While employees have expectations in employment, it is unclear that they can establish enforceable intentions in seeking remedies under implicit contracts. Thus, while implicit contract theory may be one tool to recognize or value obligations to workers, it is not adequate to address the risk to their investments on firm failure.

Another alternative is Barry Adler’s theory of chameleon equity. Adler argues that pre-insolvency contracts can provide for division of an insolvent firm and thus lower the cost of insolvency proceedings. Chameleon equity is a multi-priority contractual hierarchy that would allow a debtor corporation to replace debt with a tiered hierarchy of preferred equity. The firm would retain the benefits of fixed obligations such as discipline through managers knowing that they have to pay earnings out to investors who have the power not to renew loans, but would avoid the negative consequences of creditor collective action which frequently results in premature liquidation. If the corporation becomes insolvent, default would eliminate the pre-insolvency common

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295 This is exacerbated for employees whose first language is not English who face even greater barriers to this information. Moreover, workers, other than communities with small local labour markets, are unlikely to hear about breaches of implicit employment contracts. As a result, the reputational capital argument as a means of enforcing implicit contracts is highly questionable, ibid. at 65.

296 Daniels, supra, note 292 at 349.

297 Interestingly, this focus on actual intention of the parties is precisely what the remedial statutory scheme of human rights and labour law strove to eliminate because of the difficulty in establishing intention. Sarra, supra, note 27 at 65.

298 Tests of reasonableness of employee expectation likely differ considerably from reasonableness tests of implicit contracts grounded in current the shareholder or creditor wealth maximization paradigm. For a fuller discussion of this, see ibid. at 66.


300 Ibid. at 1110.
equity class, converting the next lowest ranking priority to the class of common shareholder. The remaining preferred classes would remain unaffected. Managers would be accountable to the common equity class and thus governance of the corporation could continue during insolvency without periods of uncertainty or unaccountability, and without costly court proceedings to determine value of the firm. Given workers' position near the bottom of the hierarchy (other than their preferred claims), this could arguably assist in providing them with a low cost avenue to acquire governance rights. However, Adler's theory of chameleon equity is premised on pre-insolvency negotiations. Thus workers face the same barriers under this model as they do under both contract theory and implicit contract theory. Absent the power to bargain a governance role on event of default, it is unclear how workers would benefit from such a structure. Moreover, if there are classes that would rank ahead of workers in terms of default equity, such as preferred shareholders, then Adler's ideas are unlikely to advance the participation and decision rights of workers and other equitable investors.

My assertion that a substantive objective of insolvency law should be to recognize and accord value to workers' human capital investments is also based on the fact that frequently such investment by workers accrues directly to the benefit of the firm in terms of organizational and informational capital. The investment generates value for the corporation through innovation, efficient production methods, or generation of customer goodwill. This value is rarely measured by fixed capital claims. The value of that investment frequently depends on its synergy with other investors and the governance structure of the firm.

Yet traditional notions of corporate governance continue to regard employees as fixed claimants, concerned with wages and working conditions, and without concern for the

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301 Ibid. at 1118.

302 Ibid. at 1111.

303 Ibid. at 1119. See also Barry Adler, "Financial and Political Theories of American Corporate Bankruptcy" (1993) 45 Stanford Law Review 311.
continued prosperity and viability of the firm.\textsuperscript{304} When the firm becomes insolvent, the common view is that workers are concerned about the viability of the business only from the very narrow perspective of payment of any wages or benefits owing or whether their jobs can be saved. Much of the scholarly work rejecting stakeholder accountability other than through enforcement of contracts or bankruptcy claims flows from this conception of workers.\textsuperscript{305} This is reinforced by the separation of corporate and labour law in which any obligation owing to workers as fixed claimants is seen to be taken care of by the labour law regime. In the context of bankruptcy, these fixed claims are further addressed by the statutory priorities for the satisfaction of a portion of their claims under the \textit{BIA} or the \textit{Bank Act}.\textsuperscript{306} There is virtually no legislated protection of workers in the event of economic restructuring, beyond very limited notice and severance pay obligations in the event of closure or partial wind-up.\textsuperscript{307} The result of this traditional view of workers is that their investments in the firm are rarely full recognized and they are rarely accorded any role in the process of developing a plan or proposal for restructuring. Even when the interests of workers converge with other investors, any value accorded that interest is reflected in priority of payment of wages, usually in the initial stay order, as opposed to meaningful participation in workout negotiations.

\textsuperscript{304} Fixed claims are specific claims to the corporation's assets based on contract - accounts payable in exchange for supplies, wages owing under employment contracts, interest and repayment charges agreed to in debt instruments. Residual claims arise from expectations, whether implicit or explicit, that the value of dealings with the firm will increase with the firm's increase in value and decrease with decrease in firm value. Black, \textit{supra}, note 181 at 16. This is a working definition of residual interest that I adopt.

\textsuperscript{305} Macey and Miller, \textit{supra}, note 156 at 417. Jensen and Meckling have described the corporation as a legal fiction which serves as a nexus for contracting relationships, and which is characterized by the existence of divisible residual claims on the assets and cash flows of the organization, complex relationships between the owners of labour and capital, and the legal system which enforces these relations. \textit{supra}, note 152 at 311. Trebilcock and Howse, while categorizing employees as fixed claimants, nevertheless acknowledge that benefits are often directly tied to the corporation, thus, creating risks greater than wage loss. They suggest that statutory and collective agreement protections for workers are "tin parachutes", which fail to recognize the risks workers face on restructuring, \textit{supra}, note 291 at 758.


\textsuperscript{307} Black suggests that workers usually do not exercise any formal control rights notwithstanding their large residual interest due to: the limited transferability of their interest; the fear of interfering with explicit and implicit employment contracts; the heterogeneity of workers' investments depending on their specific human capital; and the costs of multiple control rights. Black, \textit{supra}, note 181 at 8-9.
The effects of firm insolvency on local labour markets can be devastating, particularly in communities that are highly dependent on the corporation. Unlike shareholders who have the ability to diversify their holdings, often workers' human capital is invested entirely in the insolvent corporation. Where there is highly firm-specific human capital investment, decision-making by firms imposes a high risk on workers' investments comparable to that borne by equity investors. Shareholders, particularly in widely held companies, usually bear less residual risk than workers because of limited liability and ease of exit if not satisfied with the performance of the corporation. Workers, unlike shareholders, cannot easily diversify the risk of their investment. Retraining and acquisition of general as opposed to firm specific skills are not as effective a strategy for diversifying risk as is the ability of shareholders to diversify their portfolios. Moreover, unlike traditional creditors who have often accounted for possible insolvency in their cost of granting credit, workers rarely have the information or the bargaining power to achieve such protection.

Traditional governance mechanisms provide inadequate protection against the loss of human capital investments. As a consequence, firm failure disproportionately affects workers. Workers are often creditors who have been unable to spread the risk of default, lose their income and often quickly deplete what savings they have. Where workers have pension investments or equity holdings in the form of shares purchased in employee stock plans, their losses are even greater. Individual employment contracts, collective agreements, and public and private insurance have all proven inadequate to efficiently

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308 Ibid. at 351.

309 Ibid. at 229.

310 Gordon, supra, note 9 at 1480.

311 This occurs whether the corporation is solvent or insolvent. Marleen O'Connor, "The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labour-Management Co-operation" (1993) 78 Cornell Law Review 899 at 904.

312 Warren, supra, note 151 at 790.
spread the high risks of job loss.\textsuperscript{313} There is no obligation to assist workers with their investment losses either through training or relocation. In the current insolvency paradigm, the interests of workers are quantified as the amount of their limited fixed claims. Whether the corporation is ultimately liquidated or whether its restructured, the outcome often involves wholesale shedding of workers. The loss of human capital investment is recognized in limited rights to claim severance, however, generally firms externalize the costs of economic restructuring.\textsuperscript{314} It is only when the skill set required is so specialized that corporate decision makers need to retain workers and ensure that they continue to invest their human capital, that the human capital potential of workers is accorded priority.\textsuperscript{315} In that case, there is a congruence of interest.

My assertion that workers risk their human capital investment does not depend on establishing that their aggregate risk of loss is equal to or greater than that borne by shareholders or traditional creditors. Rather, just as different shareholders and creditors have varying degrees of investment and varying abilities to diversify risk, so too do workers. This does not detract from the notion that when the corporation becomes insolvent, creditors, shareholders and workers have a residual interest in the corporation. Like shareholders, the residual interest of workers at the point of insolvency may not be measurable in fixed capital claims or remaining equity, but they exist nevertheless. Nor does it detract from the notion that all parties have an interest in any future generation of wealth by the corporation. Both equity and human capital investors have an expectation interest in that the value of their investment will increase if the firm’s value increases, and will seriously decrease or be lost if the firm becomes bankrupt. The nature of the


\textsuperscript{314} Singer suggests that corporations and governments are content to leave the rapidly increasing numbers of unemployed workers to employment insurance, and ultimately, welfare and workfare programs. J. Singer, "Jobs and Justice: Rethinking the Stakeholder Debate" (1993) 43 U. T. L. J. 475 at 480.

\textsuperscript{315} For example, in \textit{White Rose}, the corporation submitted to the court that it was highly dependent on the goodwill of employees and thus they needed to be paid in full during the restructuring process. \textit{Re White Rose, Affidavit of L. Jolliffe}. C.F.O. White Rose (27 November 1998) Ontario Court File No. 98 CL 3178 (O.C.J. (Gen. Div.)).
human capital investment means that workers have an interest in the corporation whether it is solvent or insolvent. Once this interest is acknowledged, then decision-making by directors during development of a restructuring plan should take account of all investments at risk.

Elsewhere, I have suggested that workers’ claims are of an equitable nature such that they are deserving of special attention in the corporate governance debate. Directors and officers of the corporation should undertake decision-making in the best interests of the corporation, having regard to both the equity investments of shareholders and the equitable investments of workers. These notions apply equally at the point of insolvency, although the obligation also extends to traditional creditors. Recognition of a fiduciary obligation would be one instrument through which the substantive objective of recognizing workers’ investments in the firm would be accomplished. As will be discussed in part E of this chapter, this expanded fiduciary obligation is also an important instrument in achieving enterprise wealth maximization. Such recognition of workers' equitable investments would have two immediate implications. First, in devising restructuring plans or determining whether the corporation should be liquidated, directors and officers of insolvent corporations would be obliged to take account of the human capital investments of workers, just as they consider the equity investments of shareholders and the capital claims of traditional creditors. Moreover, just as shareholder interests are still taken into account in restructuring negotiations even though their equity

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316 Sarra, supra, note 27 at 33. I have argued that workers' human capital investments result in their interest being located along a continuum of fixed and residual claims. Those claims, while not requiring shareholding to fall in the residual category, nevertheless are deserving of special attention in the governance debate. In order to determine their interests, and thus, establish their claims, it may be that there is need to describe workers differently from either fixed or residual claimants. This could encompass a notion of “equitable investment” and equitable claims. Equitable notions are well entrenched in our law, and equitable remedies have been available where courts have found that fairness or even handedness required the ordering of a particular remedy. Concepts of equitable relief have recognized interests not strictly defined by title or by law, yet for which fairness suggests parties are deserving of remedies in particular circumstances. Applied to the governance context, workers have fixed claims under statutes and collective agreements, but their human capital investment may be deserving of broader claims. While they are not always residual claimants in the traditional sense of equity capital at risk upon failure of the firm, they do have investments at risk, investments that are usually undiversified, even if they are not specialized.
stake has been reduced to zero or almost zero, so too should workers’ interests be taken account of, even though there is risk that the value of that investment could be reduced to zero. Both shareholders and workers have contributed capital and that investment may give rise to a claim for a proportional amount of value generated if the corporation is able to successfully turn around its affairs.

Second, a key policy instrument for achieving substantive recognition of workers' equitable interests is granting workers participation and decision rights in the restructuring process. Just as shareholders may or may not have value to add to the restructured corporation, as equitable investors, workers may or may not be able to offer a unique perspective in the restructuring exercise. Recognition of informational capital they can contribute can be a key part of the process of developing a viable business plan. Moreover, at a time when directors are often “jumping ship”, governance is in disarray and directors cannot necessarily be counted on to scrutinize the activities of managers during the period of financial distress. Thus workers can provide a less costly means of monitoring the corporation’s activities during this period, and enhance decision-making regarding the most efficient means of restructuring. In part this is because their interest in the restructured corporation may be higher than other creditors. The role of workers in the Algoma Steel case discussed in chapter 5 is illustrative of this. Workers can identify efficiencies that can be gained by the restructuring and assist in the development of a sound business plan. They are uniquely situated to create added value for the firm. Thus, workers have an interest in decision-making of the corporation and potentially a significant contribution to make in ensuring its continuation as a viable

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317 For example, in Olympia & York, the Court held that the sanctioning on a plan under the CCAA must ensure that the plan is feasible and that it fairly balances the interests of all creditors, the company and its shareholders. In that case, however, there was some issue as to whether or not there was equity left. Re Olympia & York Developments v. Royal Trust Co. (1993), 17 C.B.R. (3d) at paragraph 35. Moreover, in the U.S. context, the corporation does not have to be insolvent to enter reorganization and in such cases, shareholders may still have equity interests arising out of their capital contributions. Kordana and Posner, supra, note 191 at 224.

318 Daniels, supra, note 161 at 232.
business enterprise. This requires that they have participation and decision rights in restructuring processes.

Posner and Kordana have observed that for the solvent corporation, the one-vote one-dollar system for governance reflects the strength of shareholders' incentives to make good decisions. However the same voting system in restructuring proceedings fails to take account of those who have a strong post-insolvency interest in the corporation, the parties they call the "high-value" creditors, such as workers, small creditors and trade suppliers. This combined with information asymmetries leads to strategic bargaining and less than optimal outcomes. While they do not propose how this might be resolved, it does support my theory that the nature of the interest or investments of these stakeholders needs to be accorded more value than currently recognized in the fixed capital claim framework.

In terms of defining these participation and decision rights, one can draw on existing practices under insolvency law in terms of the rights that are granted to traditional creditors as the result of their fixed capital claims. I discuss participation rights and decision rights separately because workers may have different claims to these types of instruments depending on the nature of the investments that they have at risk in the firm. Often their investments will be deserving of both kinds of rights, unlike the other stakeholders discussion in part D below.

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319 It is more difficult for workers to "jump ship", given the undiversified nature of their investments in the firm and this, combined with firm loyalty, creates an incentive for them to devise effective restructuring strategies.


321 Ibid. Kordana and Posner have observed that in negotiations for a workout under Chapter 11 proceedings under the U.S. Bankruptcy Code, the failure to recognize these high failure creditors means that optimal negotiations and workouts are not occurring.

322 Ibid. Thus they suggest that any model adopted should account for these problems.
I define participation rights as the ability to be heard in negotiations for a plan or proposal in either a private workout or under the court-supervised process. This includes having access to information to ensure informed and meaningful participation in the discussions. It involves the ability to contribute informational capital to the negotiations to ensure that all stakeholders can undertake decisions on an informed basis. Workers have a first-hand understanding of production design inefficiencies, duplication, the existence of outdated equipment that signals the need for capitalization, and other information resulting from their direct experience in the workplace. Workers may be able to identify organizational or production changes that in turn might assist in devising a viable business plan. They can enhance value through the organizational capital they contribute. Organizational capital is the value generated from a team of people who work regularly together in production; the synergy of their routines, shared experience and efficiency that creates value for the enterprise. Such participation would allow negotiations for a restructuring plan that takes account of both pre-insolvency investment and post-restructuring potential investment of workers. The challenge is to ensure that value is added by the inclusion of workers' participation in a way that outweighs the costs of the process.

In some cases, according participation rights might include having a representative on the creditors' committee in order to monitor the activities of the insolvent corporation or assist with drafting of a restructuring plan. Participation on creditors’ committees would reduce information asymmetries and allow for the informal exchange of views that so often facilitates the workout. Participation also includes the right to come before the court under the “comeback” clause in stay orders, rights that traditional creditors have to

323 Although one could argue that in some cases conferring participation rights on workers could be useful, even within a debt collection model, because of the informational capital workers bring to the table, arguably workers will be reluctant to engage in further human capital investment of this sort unless they are assured of some limited right to share in a proportion of the value that might be generated from these efficiencies.

324 Blair, supra, note 107 at 243.

325 Triantis calls these the direct costs of the legal process and indirect costs caused by the incentive effects of insolvency rules on the debtor's operations. Triantis, supra, note 1 at 102.
ensure that their interests are protected during the stay period. Participation rights should also include resources to ensure participation. Under the current regime, creditors are partially financed for their activities out of the assets of the debtor corporation. Workers as human capital investors could be accorded similar access to partial funding to ensure that they are able to participate.\textsuperscript{326} Such participation may allow workers to propose governance structures that give all parties incentives to work together efficiently and thus reduce costs of co-ordination and dispute resolution.\textsuperscript{327}

The second instrument for achieving substantive recognition of workers' interests is according decision rights. Decision rights are distinguishable from participation rights in that they carry voting rights on a proposed plan or proposal. Decision rights also carry enhanced bargaining rights because the debtor corporation will seek to win workers' support for the proposed plan before it comes before the court in the sanctioning hearing. Workers as equitable investors in the firm should be afforded enhanced decision rights in the negotiations for a restructured corporation. These decision rights should reflect not only the value of their fixed capital claims, but also their equitable investments. There are several possible ways in which the claims of workers could be recognized in this respect. The first is that their existing fixed capital claims could be re-evaluated based on some formulation that recognizes their human capital investment, such as a percentage of hours contributed or years of service.\textsuperscript{328} Alternatively, workers could be given a separate voting class for purposes of voting on a proposed plan of arrangement or compromise, which recognizes that they are uniquely situated because of the nature of their investment in the corporation.\textsuperscript{329} Alternatively, their equitable investments could be represented in a

\textsuperscript{326} This was the case in Red Cross where the Court allowed representative counsel in the mediation process regarding the pension surplus to be paid out of monies in escrow, infra, chapter 7.

\textsuperscript{327} Blair, supra, note 107 at 244.

\textsuperscript{328} Such a calculation of human capital investment in the firm is already established in seniority type provisions of collective agreements.

\textsuperscript{329} Usually all unsecured creditors are placed in the same class, thus rendering workers' voting power almost useless.
class of equitable investors and their fixed claims still reflected along with other preferred or unsecured creditors.\textsuperscript{330} The fact that workers might end up in more than one voting class is not antithetical to insolvency law. For example, currently the so-called "vulture" investors buy up claims across multiple classes in order to influence votes in each of the classes voting on the restructuring plan.\textsuperscript{331} Workers also have different kinds of fixed and equitable claims that may call for single or multiple classes.\textsuperscript{332} Under any of these options, the court would receive the benefit of workers' views through the voting process. just as the court now receives the views of traditional creditors. Where the plan is one that involves only compromise of fixed claims and not a restructuring arrangement, the court could still have the benefit of workers' views but this might involve granting intervenor status and the right to make submissions as opposed to decision rights. This is discussed in part D in this chapter in the discussion of community stakeholders whose legal rights may not be affected by a proposed plan.\textsuperscript{333}

A valuable analogy can be drawn to the situation of shareholders during insolvency. During the negotiation process for development of restructuring plans or proposals, shareholders, particularly in closely held Canadian corporations, still have important decision rights. Although there is no requirement under the CCAA or the BIA for shareholders to vote as a class in approval of a proposal or plan, courts have in the past ordered a vote of a shareholder class or classes.\textsuperscript{334} This approach is due in part to the

\textsuperscript{330} Frequently creditors hold an interest in more than one voting class.


\textsuperscript{332} There is some precedence for this in existing caselaw. See discussion of Algoma Steel Corporation, infra, Chapter 5. Moreover, landlords have in the past successfully argued for separate class representation in part because of their ongoing relationship and the fact that they are enjoined from exercising statutory and contractual remedies. Re Grafton Fraser Inc. (22 April 1992) Ontario Court of Justice (Gen. Div.), Court File No. B378/91, Houden J.

\textsuperscript{333} See discussion, infra, note 367.

\textsuperscript{334} Where there is actual change to the share structure, this is a requirement under companion corporations statutes.
central role accorded to shareholders in the solvent corporation. In insolvency, shareholder wealth maximization is not entirely subjugated to creditor wealth maximization notwithstanding the fact that shareholders have little or no capital claim to the residual assets at the point of insolvency. While a negative shareholder vote is unlikely to defeat a plan that has the overwhelming support of creditors, the establishment of the class and the consideration by the court of the wishes of shareholders speaks to their participation and decision rights. It may also influence or dictate the method by which equity is restructured. This is recognition of both the investment lost and the future right to participate in any value generated from the restructured firm, whether or not shareholders contribute any further equity capital to the corporation. Canadian courts have held that there is a role for shareholders in the process of determining whether there should be a corporate restructuring.

Workers could be given the same kind of decision rights that recognize both the value of the investment lost and the future right to participate in value generated by the workout. These are distinguishable from any voting rights they may have as fixed claimants under insolvency statutes. Just as negative shareholder votes are unlikely to defeat a plan that is overwhelmingly supported by creditors, the court would engage in the same kind of balancing of workers' votes on a restructuring plan. The importance of granting these rights is that the debtor corporation is then required to negotiate with the class in arriving at a proposed plan. The support or defeat by a voting class of workers will also assist the court in coming to an informed decision at the fairness hearing that sanctions the plan. The court would use the same tests that it currently uses to assess votes on proposed plans, specifically whether the plan meets the statutory requirements, whether the procedures carried out were authorized by the CCAA (or BIA) and whether the plan is fair

335 Clearly if the corporation is to become solvent again, shareholders might reacquire a residual interest.

336 Unless approval of the plan is dependent on approval of share structure changes under corporations' statutes.
and reasonable.\textsuperscript{337} It would, however, have an additional set of interests before it in the sanctioning decision.

The reality is that in the past decade in Canadian insolvency proceedings, where workers and their unions have sought participation rights, the court has generally granted them. In one recent case, this occurred even where their fixed claims had already been satisfied.\textsuperscript{338} The courts expressly recognize that insolvency law is ultimately a creditor process and that it is driven in large measure by the scheme of priorities in the case of bankruptcy. Thus the challenge is to craft participation and decision rights for workers and their unions that would adequately balance their interests with those of traditional creditors and other stakeholders.

In my work on governance of solvent corporations, I have suggested that the type and extent of claims that workers as equitable investors would support depends on the kind and quantum of human capital that workers have contributed, and on their reasonable expectations as investors of human capital in the particular enterprise.\textsuperscript{339} An equitable approach provides a more textured way of addressing the increasingly segmented and contingent nature of labour markets. Rather than ground residual claims entirely on the notion of expectations of long-term human capital investment, an equitable approach could take account of situations where workers have made shorter term human capital investments which are at risk. While greater than fixed claims, they may be insufficient to establish a full residual interest, based on equitable considerations. Recognition of these claims could ensure that decision-making takes account of all investments at risk in the firm. In turn, this could result in governance structures that allocate decision and

\textsuperscript{337} See the discussion in chapter 3, \textit{infra}, part D, regarding these tests.

\textsuperscript{338} See discussion of Anvil Range, \textit{infra}, chapter 6.

\textsuperscript{339} Sarra, \textit{supra}, note 27 at 15.
control rights to those who have the incentive to use resources efficiently to create wealth. \textsuperscript{340}

A central question in restructuring decisions is how to allocate value when the value of the debtor corporation is unclear. \textsuperscript{341} In terms of workers’ human capital contributions, if one is to accept my assertion that workers have equitable investments, the challenge is to quantify the claims or accord a value of that investment in some way that determines what the nature and scope of their participation and decision rights should be. If one considers the above discussion on the convergence and divergence of interests, it seems evident that consideration of interests, beyond fixed capital claims, is already part of the restructuring equation. Traditional creditors do not negotiate solely in terms of their fixed claims; all other factors regarding where their interests may converge come into play. Frost argues that a rigid system of governance based on illusive valuation concepts is unworkable, and thus a fluid decision-making process is necessary because of the pragmatic needs of speed, efficiency and inability to accurately value interest. \textsuperscript{342} This notion applies to equitable investments. Formal valuation processes are costly and thus may create a barrier to workers’ participation. It is possible, however, to quantify equitable investments. Accountants and actuaries currently price the costs and benefits of firm failure to community, trade creditors, and related businesses. \textsuperscript{343} Collective agreements currently accord value to workers’ investments in terms of seniority provisions. Thus, parties could propose measures to determine value through these kinds of mechanisms. Even where the value of equitable investments is not quantifiable in a

\textsuperscript{340} Blair, \textit{supra}, note 107 at 3, 19.

\textsuperscript{341} Frost, \textit{supra}, note 202 at 95, 135. He suggests that judicial decision making should revolve around locating where the residual claims lie and should give more weight to that group’s view of the particular decision at issue. In turn, he suggests that this would provide a rough substitute for contractual and market aspects of governance during the restructuring process.

\textsuperscript{342} \textit{Ibid.} at 112.

\textsuperscript{343} For example, such costs were calculated in the \textit{Skydome} case and in \textit{Algoma Steel Corporation}, \textit{infra}, chapters 6 and 7. An example of similar calculations would be forced liquidation analysis by external accounting experts, see Arthur Jacques, “United Co-operatives of Ontario” in Ziegel and Baird, \textit{supra}, note 6, 595 at 598.
cost-efficient way, creative alternatives can be used to accord workers decision rights. The use of the "one vote per tort claimant" for purposes only of voting on the proposed Red Cross plan of arrangement is a good example of this, discussed further in chapter 7.

Just as courts have intervened to rectify oppressive conduct on behalf of shareholders and traditional creditors, protecting their interests in terms of their reasonable expectations, so too could the judiciary assist in setting the parameters of the obligation to workers as equitable investors in terms of their reasonable expectations. As with current beneficiaries of the oppression remedy, courts would only interfere with business decisions when directors fail to act in the best interests of the corporation, act in a manner that is oppressive, unfairly prejudicial or unfairly disregards workers' interests. This is discussed further in Part E of this chapter.

In terms of negotiations for the workout under restructuring proceedings, workers would bargain for compromises or arrangements that protected as much as possible their equitable investments, just as traditional creditors currently bargain to protect their debt claims. Valid compromise of their claims could encompass enhanced participation in the governance of the corporation, or claims that the corporation should give priority to job security as recognition of workers' human capital investment. Other claims could encompass periods of job security in exchange for continued human capital investment or governance change in decision-making on the shop floor. There is some evidence to suggest that workers only benefit in restructurings when any additional human capital or other investment is accompanied by a shift in the way in which the corporation is


345 Sarra, supra, note 27 at 15. Some may suggest that the statutory language would have to be changed to protect workers' reasonable expectations. The current language of corporations statutes allows for such an expansion of fiduciary obligation. However, absent legislative direction, I have argued that courts may be reluctant to import such notions into the law. The exception may be in cases where the fixed claims of workers are of sufficient value that the court will react to conduct that is oppressive or unfairly prejudicial to workers' interests.
governed. When the corporation is financially distressed, employee ownership or equity investment can assist in allocating transition costs.

Workers may be able to negotiate arrangements of profit or gain-sharing that recognize workers' contribution to productivity and turn-around of the corporation. The negotiations for a workout in the Algoma Steel case, discussed in chapter 5, is a good illustration of this. Where workers are unionized, there is already a mechanism in place that allows participation and decision making through the exclusive bargaining agent. This in turn reduces transaction costs associated with participation and decision rights. What is needed is to enhance the capacity of workers to bargain for protection of their future as well as past investments in the firm in terms of a right to a proportional share of the future value generated. In turn, the equitable investments of workers could be more explicitly recognized and utilized in the governance of the restructured corporation.

This is not to suggest that workers' interests would or should always prevail. Rather, their fixed capital and human capital claims would be accorded a value, either on consent of the parties or by the court. As discussed above, this might involve a calculation based on years of service, contribution to productivity or other actuarial calculation. This value would better reflect their claims and enhance their ability to negotiate for a workout. Successful development of the plan would then depend on co-operation and the requisite levels of support among stakeholders. The first cases measuring such value would then provide parties with information regarding the type and value of such investments so that

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346 Blair, supra, note 107; Black, supra, note 181; O'Connor, supra, note 311 and studies cited therein.

347 Especially where the corporation has the cost of bargaining with the union under labour laws. Black, supra, note 180 at 10.

348 This is to enhance, not supplant rights and benefits workers currently have under collective agreements and employment contracts.

349 Gordon also suggests that all stakeholders should bear some of the transition costs associated with economic change, rather than just workers and governments as is frequently the case now. He argues that collective bargaining ensures protection against the costs of economic adjustment, including additional compensation for risks that workers bear. Gordon, supra, note 9 at 1483. However, Gordon fails to note
they can then engage in the delicate negotiating balance that ultimately leads to an agreement.

Under such an approach, courts would be better able to balance the interests of workers with those of traditional creditors. As will be apparent in the discussion of the current regime in chapter 3, courts already exercise their equitable jurisdiction to balance the diverse interests involved in restructuring applications. In the Canadian Red Cross case discussed in chapter 7, the court's endorsement of a role for unions and other stakeholders in the negotiations for a workout suggests that certain elements of my model are being implemented. Formal recognition of workers' equitable investments could result in enhanced negotiations for the plan or proposal; would ensure the court's express consideration of those interests in the balancing that it undertakes in determining whether to sanction a plan; and ultimately could enhance the actual decisions made to have an effective outcome, specifically the turn around in the corporation's economic health.

Formal recognition would allow any interest that workers have in gaining access to the governance of the restructured corporation to be expressed. Workers may or may not desire governance change depending on the political philosophy of the union and whether they view their role in the restructuring as purely transitional or a long-term investment. As with any creditor in the restructuring process, a demand for seats on the board or other control rights would not be guaranteed, but rather, would be part of the process. As with creditors' interest in governance change, this would be part of negotiations, and unions would participate because of both their fixed and equitable claims. Failure to reach a negotiated agreement on such governance changes would then be reflected in support for the plan in the vote, such as occurs with traditional creditors now. If parties are required to consider both the interests and the input of workers, then the informational capital they bring to the bargaining table, if it can contribute value, is likely to form part of the plan.

that this is entirely dependent on the union's bargaining power, which is usually at its lowest during insolvency unless the skills are very specialized and thus workers or their unions can extract a premium.
Much of the above discussion assumes that a union is in place that will represent the collective interests of workers in a cost effective manner, thus controlling transaction costs in the restructuring process. However, there are examples where non-unionized workers have overcome collective action problems in CCAA applications by forming workers' committees representative of employees. The resolution of the pension surplus issues in the Birks case and in the Confederation Life cases are good examples of this. Moreover, if a pension trust is involved, those workers can be named as a class under class proceedings statutes or pension legislation and have representatives of beneficiaries and counsel named for them. Most recently, in Eaton's application to develop a proposal under the BIA and then the Court approved transfer of the application to a proceeding under the CCAA, the Court granted status to a representative employee. The representative employee and its counsel are authorized to represent all current and former employees in negotiations with the company, and legal and professional costs are being paid as the same priority as the interim receiver or trustee in bankruptcy. This has created a mechanism whereby the voice of the workers is being heard as part of the workout process, even though there is not a union present to represent those collective interests.

The underlying premise of recognizing workers as investors in the process to negotiate the workout is that there is value on the table that is otherwise lost if the human capital that workers contribute is not recognized. However, until that interest is fully recognized, workers and their unions will have to place the information before the court to persuade it of the quantum of workers' investment at risk and the monetary impact of future opportunities given up today.

350 In Birks the employee representatives undertook a highly organized process of information dissemination, meetings and approval by courts and pension authorities across Canada, thus facilitating the restructuring process and reducing transaction costs. The settlement was that 60% of the pension surplus belonged to employees and 40% was available to the company to satisfy creditors' claims. Max Mendelsohn, "The Re-Emergence of the Blue Box: The Restructuring of Birks Business" in Ziegel and Baird, supra, note 6 at 411. Alternatively, parties could seek status under provincial class proceedings statutes. See for example, the Ontario Class Proceedings Act, 1992, S.O. 1992, c. 6.

351 In the Matter of the Proposal of the T. Eaton Company Limited, Court File No. 31OR- 364921, Order (27 August 1999) (Ontario Superior Court of Justice (Commercial List)), Farley J.
Finally, one issue I note that deserves future study is whether the recognition of workers' equitable investments will be facilitated by institutional investors whose funds are derived from workers' contributions. In the United States, pension funds as institutional investors are increasingly seeking governance changes in and outside of insolvency.\footnote{Labour pension fund assets in the United States are currently the single largest source of capital, comprising 35% of equity holdings. \textit{Kissane, supra}, note 24 at 1354. See also R. Romano, “Public Pension Fund Activism in Corporate Governance” (1993) 93 Columbia Law Review 795; K. Montgomery, “Market Shift – The Role of Institutional Investors in Corporate Governance” (1996) Canadian Business Law Journal 26 at 190-91.} As in Canada, some of these initiatives are restricted by fiduciary obligation in favour of current beneficiaries. However, institutional investors have in some cases recognized that the balance sheet does not adequately capture the value of the workforce to the debtor corporation. They have commenced making investment decisions that seek to maximize return on their investments by measuring long-term economic performance through workplace practice as one indicium of overall value generated by the firm.\footnote{Kissane, \textit{supra}, note 24 at 1360, the California pension fund, CalPERS is illustrative of this change. Mark Kessel has reported that a 1996 study of the “CalPERS’ effect concluded that after ten years of targeting companies to improve performance, the 62 targeted companies showed stock returns 34% above the index returns over 5 years, whereas the same companies were 85% below the five years preceding CalPERS’ involvement. Kessel, \textit{supra}, note 152 at 2.} Their aim is to maximize returns for investors by improving corporate governance, and they have recognized that human capital investment is an important measure of enhanced economic performance.\footnote{Blair, \textit{supra}, note 107 at 189. Pension funds are also recognizing the need to tailor these strategies to the particular governance model in each jurisdiction, see for example the efforts of CalPERS in France. \textit{Kissane, supra}, note 24 at 636.} Thus when insolvent firms are seeking out additional sources of capital in restructuring negotiations, such investors can use their bargaining leverage to require enhanced consideration of workers’ interests.

In Canada, pension funds and other worker-funded institutional investors such as Labour Sponsored Investment Funds (LSIFs) are key existing and potential investors in the decision to restructure insolvent corporations. This is because there has been rapid
expansion of pools of pension capital in the past decade, spurred by population trends, high contributions to pension funds, particularly in the public sector, and changes in legislation in terms of the ability of pension plans to invest. In 1996 pension funds and mutual funds had $180 billion dollars invested in Canadian shares. Since pension funds are required to own 80% of their assets in Canada, the plans have limited opportunity for exit, leaving governance strategies as the most viable option to maximize value. However, in Canada, pension funds are bound by English and Canadian court decisions that have held that their fiduciary duty is solely to the current beneficiaries, not to employees as future beneficiaries. While Canadian pension funds have not to date taken the same steps to protect workers’ interests in terms of governance, as similar funds in the U.S. have, there is considerable potential in the insolvency context where the business is clearly viable and such investors may be willing to invest in the reorganized corporation. Workers are increasingly bargaining for joint governance of defined pension plans and if this trend continues the governance priorities of such funds may alter. Pension funds have been the source of funding in a number of successful CCAA applications and, in at least one case, the fund itself proposed a plan that formed the basis for successful negotiations. However, as the Med-Chem case discussed in chapter 8 illustrates, the decision making structure of these funds may not be conducive to the short time exigencies of CCAA proceedings.


356 Ibid. at 3.

357 Ibid. at 5.


359 See for example the Ontario Public Service Employees Union and the Teamsters Pension Plan. They would like to draw on the U.S. experience of successfully arguing that good employment practices actually enhance firm value and thus are one measure of how to maximize investment return for beneficiaries. Cameron Nelson, President, Brewery, General and Professional Workers’ Union, interview (3 August 1999).
Similarly, the growth of LSIFs has provided an important source of capital and investment possibilities that may potentially recognize workers' human capital investments. Encouraged by federal and provincial legislation in the early 1990s, LSIFs raise capital from workers and other investors and invest that capital in Canadian enterprises as a means of retaining jobs and economic activity in the country. By 1995, LSIFs in Canada had 1.9 billion dollars in assets, with all of their investments in Canada. These institutional investors may be able to actively push for recognition of workers' human capital investments in corporate decisions to restructure because their transaction costs are spread across numerous investments in order to minimize risk. Their investment income is generated from workers similarly situated, who have invested in such funds in order to help retain economic activity and jobs in Canada. In some cases, the funds already engage in workplace audits and refuse to invest in businesses that have poor workers' compensation, environmental, human rights or labour relations records, thus combining recognition of human capital investments with sound business and investment practices. For example, in considering investments, Manitoba's Crocus Fund has a stated objective of promoting worker participation in corporate governance. Institutional investors funded by workers' contributions or workers' investments may be one vehicle to protect human capital investments in terms of insolvent corporations, however, it is likely that these investors will be interested in only

360 Oakwood Petroleums Ltd. discussed in Richard Jones and Richard Dixon, "Oakwood Petroleums Ltd. in Ziegel and Baird. supra, note 6, 345 at 371.

361 For a discussion of the origins and growth of Labour Sponsored Investment Funds, see Sarra, supra, note 27 at 888.


363 Canadian Labour Market and Productivity Centre, The Role and Performance of Labour Sponsored Investment Funds in Canada (Ottawa: Canadian Labour Market and Productivity Centre, 1995) at 6-9.

364 Sarra, supra, note 27 at 86.

365 See for example, First Ontario Labour Sponsored Investment Fund. Kenneth Delaney, President and CEO, interviews (12 February 1998) and (11 June 1998).

366 Jack Quarter, Crossing the Line: Unionized Employee Ownership and Investment Funds (Toronto: James Lorimer & Company, 1995) at 144, 145, 160. The Fund supports where feasible, investments that will increase employee ownership.
the lowest risk workouts given their fiduciary obligations where they are already investors in the insolvent firm. However, their at risk investments may give them bargaining power that assists workers in protecting their equitable investments. To date this aspect of governance of the insolvent corporation and negotiations for a workout has not been seriously explored and is fertile ground for future study.

Given the complexity of restructuring cases and the diversity of claims and interests, it is not possible to set out one formula for the recognition of workers' rights to participate and vote in decisions regarding the future of the insolvent corporation. What is evident, however, is that there a variety of means through which this could be accomplished, likely to be further developed through the caselaw and the creative efforts of the parties themselves.

D. An Expanded Definition of Creditors or Stakeholders

While workers are uniquely situated in the governance debate, they are not the only stakeholders who have investments at risk in the corporation. Local communities, governments, and others have investments at risk, although claims arising from these interests may be harder to fully determine. The third component in my proposed conceptual framework is the recognition of other stakeholder interests where they can establish equitable claims. In many insolvencies, there are diverse types of stakeholders who have investments at risk and who may be entitled to participation and decision rights in developing restructuring proposals depending on the nature of their interest. Just as the interests of traditional creditors do not necessarily converge, this is also the case with non-traditional creditors or stakeholders.
An expanded definition of creditor or stakeholder can take account of two broad types of interest. The first are those who are already recognized by legislators and the courts as creditors in terms of statutory preferred claims, crown claims, or common law claims such as tort claims. Some are involuntary creditors in the sense of tort claimants and arguably local governments.367 Others such as local trade suppliers, are voluntary creditors in the sense that they expressly gave credit through the forwarding of goods.368 In many cases, particularly in smaller or northern communities, the interest of these stakeholders extends beyond their fixed claims. Thus, they may also fall into a second type of stake-holding, one which is not a direct capital claim but which nevertheless represents an investment at risk. Stakeholders may also have fixed claims that are relatively insignificant in terms of overall amount of debt. However, their equitable claims may be of far greater value. Yet these claims have not traditionally been recognized other than under broad notions of the "public interest". Moreover, often stakeholders with a mix of fixed capital and equitable claims are interested in both remedies for past action, i.e. taxes owed and remedial environmental orders, as well as an interest in future operations, such as job retention or protection of the environment.

For example, local and provincial governments have an interest beyond debts owing for property taxes or public utilities.369 For example, in Royal Oak Mines, the British Columbia Government had contributed $162 million in economic assistance and

367 See Davis and Ziegel for a discussion of whether governments are voluntary creditors, supra, note 25. Once a corporation is bankrupt, liens by municipal governments for business taxes are not secured for purposes of distribution under the BIA, supra, note 5. Re Everingham Brothers Ltd. (1999), 43 O.R. (3d) 594 (Ont. C.A.). Thus it is in their interests to have reorganization.

368 Small trade creditors often suffer greater percentage losses on insolvency and often have not bargained for the risk of those losses in the credit arrangement. Black suggests that this is because of the default rights of the banks, their systems for early monitoring and the fact that it is easier for the corporation to negotiate with the banks. Black, supra, note 181 at 11.

369 Although in the early 1990's the caselaw was unsettled with respect to the issue of whether the Crown was bound to stay provisions and plans under the CCAA, the 1997 amendments now expressly provide that the Crown is subject to the CCAA. For a better understanding of the jurisprudence prior to 1997, see Fine's Flowers Ltd. (1993), 22 C.B.R. (3d) 1 (Ont. C.A.); Re Gaston H. Poulis Contractor Ltd. (1992), 10 C.B.R. (3d) 1 (Ont., General Division); Canada (Procureur général c. Entreprises Jean Mercier limitée (1992) 15 C.B.R. (3d) 35 (Cour d'appel du Québec).
investment in the Kemess Mine.\textsuperscript{370} However, a concurrent interest by the government was environmental protection. One of the cash flow issues facing Royal Oak at the time of the initial stay order was the decision by the provincial Ministry of Environment to temporarily cease operations at the mine pending resolution of outstanding environmental issues.\textsuperscript{371}

Often local governments have invested in corporations in terms of building schools, community centres, parks and other infrastructure that supports the firm’s employees in the community. Local or provincial governments frequently agree not to enforce zoning by-laws or environmental protection orders in order to retain corporations in their communities. This is because of the contribution these firms make to the economic health of the community. Frequently local governments do not have the bargaining power to negotiate some sort of compensation or claim in the event of insolvency.\textsuperscript{372} These investments are then at risk when the firm becomes insolvent. Governments are also often left with the costs of social and economic upheaval that occurs when a firm fails. These costs include not only costs to welfare rolls and social service and health care that may be associated with this, but also losses to municipal tax bases and the costs accruing to governments of attempting to retrain workers and to generate recovery of the local economy. These costs have in recent years been exacerbated by the off-loading of responsibility for many social programmes by federal and provincial governments onto local tax bases. Firm failure, while not easily quantifiable in terms of lost investment to the community, can often clearly place local communities at risk.\textsuperscript{373} Thus, the nature of investments by local governments runs along a continuum of fixed and other equitable claims, just as those of workers. This is a form of reliance interest in that governments

\textsuperscript{370} Re Royal Oak Mines, Affidavit of M. Witte, C.E.O., at paragraph 16, 26. See infra, note 591.

\textsuperscript{371} Ibid. at paragraph 53.

\textsuperscript{372} Small communities also often do not have the resources or sophistication to bargain for such protection against risk of failure.

\textsuperscript{373} Daniel points out that there are real costs of plant shut down in terms of economic and social health, supra, note 154 at 154-157.
and communities expect to benefit from their investments in local infrastructure, training and economic development.

Yet governments intervene only infrequently in restructuring processes, and often it is only to protect their direct capital claims. While they absorb the adjustment costs of harms to workers and community from firm failure, they rarely insist on an active role in the negotiations for a viable business plan. There are exceptions - the Algoma Steel and Anvil Range cases discussed in chapters 5 and 6 are notable examples. Yet it seems that there is enormous potential for governments to contribute to the discussion of the future of the corporation and how it can be successfully restructured.

Similarly, local trade creditors, while having been recognized as creditors in insolvency proceedings, often have interests beyond their fixed claims. For example, in the Dylex case, the impact of corporate failure would not only have been 13,500 direct jobs, but an estimated 30,000 indirect jobs. Thus, it is not only the direct capital claim that is at risk, but also the local trade suppliers’ investment in the community and the risks to their employees. Often the claims of individual trade suppliers in communities are small compared to secured lenders, but it is impossible for them to diversify risk, to acquire affordable credit insurance or engage in preventive monitoring. Recognition of these interests may enhance decision making regarding restructuring. They are potentially "high value creditors" as Posner and Kordana have suggested.

Tort claimants are another group of stakeholders whose claims focus on past actions of the corporation. Courts have increasingly recognized these involuntary creditors. Essentially, if their claims are roughly quantifiable and there is reasonable certainty that there is a claim, they are considered creditors within the meaning of insolvency legislation. The claims may or may not be easily quantifiable and they may not be

375 Black, supra, note 181 at 11.
376 Posner and Kordana, supra, note 191 at 176.
fixed in terms of harm, costs to health, and other common law damages. Here, the Canadian courts have followed the U.S. example somewhat. In cases such as Dow Chemical and Johns Manville, American courts have recognized tort claimants as creditors and have accorded them rights in Chapter 11 reorganization proceedings. The negotiation and settlement of their claims has formed part of the development and endorsement of corporate workouts. As will be seen in the discussion of *Red Cross*, the Ontario Superior Court of Justice has accorded tort claimants participation rights, recognizing their claims in terms of defining classes of creditors, and sanctioning an order in which federal and provincial governments would fund the costs of representative counsel in negotiations for a plan of arrangement. The difference between tort claimants and other stakeholders discussed above, is that their claims arise out of the past actions of agents of the corporation and they do not have an investment in the future of the insolvent corporation. In this respect, they resemble traditional creditors more than equitable investors. As a consequence, they have little incentive to negotiate a viable restructuring plan unless persuaded it will generate considerably more than the immediate liquidation value of their claims. The discussion of *Red Cross* in chapter 7 explores these issues further.

Finally, there is the question of communities generally and their investment in the economic health of corporations. This is particularly the case in small and northern communities when entire communities are based on the presence of a corporation and the particular economic activity it generates. Mining and logging communities are the clearest illustration of this, but they are by no means the only examples. Communities may in some cases be distinguishable from local governments. The definition of community can include church groups, ratepayers associations, local businesses that benefit from the spin off economic activities of the corporation, school authorities and other services that have evolved to provide the infrastructure for the corporations'  

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377 *Bla*, supra, note 5.

378 See for example, *Algoma Steel Corporation* and *Abitibi Paper*, discussed in Chapter 5.
employees. Often these parties have made investments of a reliance nature in terms of the continued operation of the firm in the community. Unlike those with fixed capital claims, these claims are not easily quantifiable. While local community members may not have direct capital claims, the economic and social life of the community may be at serious risk on firm failure. For resource industries, often at the point of insolvency, it is not clear what the ultimate environmental costs to the community will be of the shut down of operations. The community’s interest may extend beyond any direct costs for clean up to an interest in ensuring the site is generally available for future economic activity.

Where these stakeholder groups clearly have an interest of an equitable nature, then a substantive objective of insolvency law should be recognition of these interests for some of the same reasons as discussed for workers. Thus, depending on where these non-traditional creditors or stakeholders are situated, they may have claims to participation and/or decision rights in the negotiations for restructuring. Where they have investments in the firm that are at risk, they may have further capital to invest in the restructured corporation in terms of injections of equity, investment through debt forgiveness, environmental liability waiver, or other contributions.

However, the reliance interest of such stakeholders may be difficult to quantify. In particular, there are problems quantifying the amount of cost that should be internalized to the particular insolvent firm. As a result, use of participation and decision rights may only be appropriate as a policy instrument where claimants can establish both investments of a reliance nature and an interest in the future activities of the corporation. One indicium might be whether these stakeholders can contribute useful informational capital to the decision making process as compared with workers. For example, tort claimants, whose interest arises out of the past actions of the corporation, may have little to contribute to development of a viable business plan. Unlike the stakeholders discussed above who have both fixed and equitable claims, I am not persuaded that parts of communities with a more tangential link with the corporation should be accorded

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379 Thus enhancing the ability of the corporation to attract and retain employees.
participation and decision rights. There is a difference between my view that equitable investors in the firm have interests beyond their fixed capital claims, and the suggestion that those who have no direct link to the corporation should be parties to the restructuring exercise. While both types of interests arguably give rise to the court's consideration of the "public interest", the instruments for recognition of these claims may not include decision rights.

Gross defines community as those persons, including governments, who can establish a nexus with the debtor corporation and for whom there is a substantial injury caused by the bankruptcy filing, and one in which the injury is redressable through the restructuring process.\textsuperscript{380} She proposes a two-fold test in which to recognize the interests of community. First, the community must establish that it shares an “identifiable nexus” with the debtor corporation, whether on economic grounds or grounds of social welfare.\textsuperscript{381} Second, the community must establish a “real and palpable injury” which is capable of being redressed.\textsuperscript{382} Gross suggests that in making such determinations, judges should embrace contextual decision making and use the full scope of their equitable powers.\textsuperscript{383} Her approach is one way in which insolvency law could take account of community interests. Its appeal is the requirement that the community establish some sort of nexus with the corporation and that it establish harm as the result of the insolvency. The problem with her analysis is that it would likely generate considerable litigation as parties seek to resolve disputes about the nature and quantum of claims. Where parties agree to the involvement of such stakeholders, courts should


\textsuperscript{381} \textit{Ibid.} at 203, 212. She distinguishes herself from communitarians who suggest that social good should prevail. See also Rosa Eckstein, “Towards a Communitarian Theory of Responsibility: Bearing the Burden of the Unintended” (1991) U. Miami L.R. 843 at 851, in which she suggests that whenever a court redistributes rights, it applies public values and draws on normative principles that implicate public value.

\textsuperscript{382} \textit{Ibid.} at 212.

\textsuperscript{383} \textit{Ibid.} At 238. Gross suggests the courts could use a balancing test not unlike that used now in assessing whether the corporation will be allowed to repudiate a union contract. She would also empower the court to consider the interests of community on its own motion.
endorse that agreement as contributing to enhanced decision making. However, where parties do not agree, adoption of Gross' model would place considerable expense and onus on the community seeking participation. Creditors and shareholders alike would be concerned about the diversion of resources to litigate questions of interest. In this sense, the second category of stakeholders, those, i.e. those who do not have capital claims already recognized by the courts, may require some other means of expressing their interests.

Another possible avenue is to allow such stakeholders to seek the status of *amicus curiae* in proceedings before the court. Such participation has been long established by the courts and is generally restricted to those cases in which the court is in need of assistance because there is a failure to have a particular perspective represented at the hearing. Thus where a community stakeholder could persuade the court that it was missing an important perspective in the consideration of a proposed plan of arrangement or compromise, the court could exercise its discretion to grant *amicus curiae* status. The court would then have the benefit of hearing from these interests even though they were unable to establish a formal claim under insolvency legislation. The court would not grant the status if the issues raised would widen the *lis*. Similarly, where the community group represented a perspective that was covered by existing parties, including stakeholders with both fixed and equitable claims, the court would find that the participation of community was unnecessary.

Both Gross' approach and the *amicus curiae* avenue are problematic. First there is the problem of "invisibility"; for those that view insolvency as strictly a debt collection

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384 Interestingly, in one of the earliest cases under the CCAA in 1933, the debtor corporation appeared as *amicus curiae* before the court because it was unclear whether it had any other status. The court expressed concern that it was more a party of interest that a friend of the court. That appears may have precipitated early recognition of the right of the shareholders to participate in insolvency proceedings. *Re Arthur Flint Co. Ltd.* (1944), 25 C.B.R. 156 (Ont.) at 163.


regime, the indirect costs of insolvency are invisible and not accounted for in decision-making. In order to accord participation rights, there would first have to be an acknowledgment that such adjustment costs are the responsibility of the corporation given the investments that parties have made in the firm and that such costs should not be borne exclusively by governments. It is here that Gross' nexus approach makes the most sense. The corporation would have to account for stakeholder interests only if those stakeholders have made reliance investments in the firm that are now at risk.

The second argument against the involvement of community is that there would be limited utility and too tangential an interest. Consideration of such interests would detract from the creditor wealth maximization model. This is answered if one endorses my proposal that the objective is enterprise wealth maximization. However, even if this is the substantive policy objective, it may be that the notion of community has nothing further to offer if the equitable investments of workers, suppliers, and local governments are recognized more fully. For example, issues such as environmental harm can be represented by local governments.

Third, such participation may be cost-prohibitive. While community interests are recognized, the costs of taking such interests into account in terms of legal proceedings and professional costs may exceed any merit in the exercise. This is a legitimate concern. The transaction costs of a court-supervised restructuring are already high and a cost-effective means of participation is required or such participation may not be viable. Yet to limit such participation only to those who already have fixed claims, might eliminate the participation of stakeholders whose fixed claims have been satisfied, but who have equitable claims such that their participation is warranted. Moreover, even where

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387 Ibid.

388 Gross, supra, note 30 at 193.

389 Ibid. at 193.

390 This was the case in Anvil Range, infra, discussion in Chapter 6.
communities do not seek formal participation rights, they can facilitate bringing parties to
the bargaining table, as occurred in the Algoma Steel case discussed in chapter 5.

As will be illustrated in chapters 5 to 7, Canadian courts have increasingly been willing to
recognize and accord participation rights to non-traditional creditors whether their claims
are contingent or not. In some cases, that recognition has included funding for
representative counsel for such stakeholders out of the remaining assets of the
corporation in order to make their participation rights meaningful.\footnote{391} However,
generally, courts have granted this recognition only where there are quantifiable or
established capital claims on the corporation's assets. Rarely do they recognize the
investments further along the continuum.

One possible solution to the problems posed by Gross' proposal or use of amicus curiae
standing, is to suggest that where parties have an interest in a restructuring proceeding
and yet they do not have fixed capital claims that would necessarily ensure that their
views are before the court, that they seek intervenor status. For example, Rule 13 of the
Ontario Rules of Civil Procedure provides for two forms of intervention. A non-party
may seek leave on her or his own motion to intervene in the proceeding as a party, on the
ground that she or he has an interest in the subject matter of the proceeding or its
outcome.\footnote{392} This rule envisions that the intervenor may become involved in the fact-
finding process.\footnote{393} Rule 13 also provides for a person to intervene in a proceeding as a
friend of the court for the purpose of rendering assistance to the court by way of
argument, without becoming a party.\footnote{394} Under these rules, the court has generally
allowed such interventions to permit a person to protect an interest that might be
adversely affected or where there is a likelihood that the party seeking intervention can
make a useful contribution to the resolution of the proceeding without causing injustice to

\footnote{391}{See discussion of pension mediation in Canadian Red Cross, infra, Chapter 6.}

\footnote{392}{Rule 13, Ontario Rules of Civil Procedure (Toronto: Carswell, 1999).}

\footnote{393}{"Highlights, Rule 13", ibid. at 310.}

\footnote{394}{Rule 13.02, Ontario Rules of Civil Procedure, ibid.}
the immediate parties.395 Thus, where the equitable claims of local governments or other stakeholders are such that they should be before the court, this is a viable means to accomplish this. Given the court’s express findings that it considers the “public interest” in restructuring proceedings, it is likely that it would accord this status in the appropriate case.

These would thus involve participation as opposed to decision rights as the policy instrument to achieve the objective of recognizing their interest in the firm. As with workers, such participation rights must be accompanied by extensive disclosure by the debtor corporation, and where appropriate, funding that ensures the meaningful participation of these stakeholders in the restructuring application process. There are precedents for such funding. Currently, creditors’ committees are funded or partially funded out of the residual assets of the corporation.396 The policy rationale behind this is that if creditors are ultimately to have their claims deferred, compromised or converted, they should not bear the entire cost of the process to work that out. Similarly, given the investments at risk by non-traditional creditors or stakeholders, their ability to participate in the process should not be precluded by the lack of resources. Given that in many cases their claims will be deferred or compromised, they should not have to bear the entire cost of their participation. The court in its supervisory capacity can ensure that any access to such funding does not unnecessarily deplete the remaining assets of the corporation, a function that it already performs. Moreover, the court has held that it depends on the parties, including creditors’ committees, to monitor the situation during the stay period and during negotiations for an acceptable plan.397 The addition of non-traditional

395 See for example: Peel (Regional Municipality) v. Great Atlantic and Pacific Co. of Canada (1990), 74 O.R. (2d) 164; General Dynamics Corp. v. Veliots (1987), 61 O.R. (2d) 111, 21 C.P.C. (2d) 169, 23 O.A.C. 339 (Div. Crt.), leave to appeal refused 21 C.P.C. (2d) 169n. Similarly, although the rules promulgated under the BIA do not expressly provide for intervenor status of this nature, the court could exercise its equitable jurisdiction to accord status.

396 In many cases the security provides for it, however, the court will often appoint a creditors’ committee of senior unsecured creditors. McLaren, supra, note 37 at 4:1300.

397 Re Cadillac Fairview Inc. (1995), 53 A.C.W.S. (3d) 305 (Ont. Ct. (Gen. Div.)), Farley J.
creditors or representative counsel on behalf of broad numbers of stakeholders may provide a cost effective means of monitoring the debtor corporation and of facilitating negotiations for the workout.

E. Enterprise Value Maximization as a Substantive Objective of Insolvency Law

One of the most controversial debates regarding the objective of insolvency and bankruptcy law is whether distributional goals force losses on those with expectation of repayment, specifically, secured and senior creditors.398 Our current scheme of debt collection already allocates costs and benefits through the existence of statutorily imposed priority of payment, statutory preferences for workers' wages, tort claims and other preferred claims. These reflect public policy about the inability of these claimants to contract for risk of loss. Sophisticated creditors have greater information on which to assess their risk of loss and thus account for this in their investment decision-making, and in the terms and conditions on which they will advance secured credit. Warren suggests that in restructuring, the benefits accruing to employees, suppliers and local communities relying on the continuation of the corporation are purchased at the expense of secured creditors who give up collection rights as part of the restructuring plan.399 She points out, however, that someone always bears the costs of default and that insolvency law merely distributes those costs.400

398 Warren, supra, note 151 at 789.
399 Ibid. at 789.
400 Ibid. at 790.
Given the diverse interests and competing objectives during insolvency, shareholders and creditors have incentives to seek to maximize their claims, regardless of the possible adverse consequences to other stakeholders or overall value of the firm. While secured creditors may have the largest stake in the outcome of the decision, given their diverse interests, they may not necessarily advocate enterprise wealth maximization. Yet, given their voting and thus, bargaining power, they are key to a successful workout because absent their support, the plan will not receive the requisite statutory threshold for approval.

Corporations generate wealth by maximizing production and generating consumer and product surplus value for the overall welfare of the enterprise. This wealth creation includes generating a greater flow of value to investors than would occur if they invested elsewhere, including the human capital investments of workers and other creditors. If the wealth captured by these groups exceeds the external costs to the corporation such as environmental liability or satisfaction of claims for harm, then the corporation is creating wealth. This notion of wealth creation is different from simply a shareholder wealth maximization objective, because it measures wealth creation across all of the investors. It is generally accepted that enterprise wealth maximization occurs where complex relationships between creditors, workers, and managers interact in a cost effective, productive and innovative manner. The disagreement occurs between those who believe it can be effectively created through contractual relationships, and those who suggest that it can be optimally accomplished only through governance mechanisms that directly account for the at-risk investments of all of these parties.

401 Lin, supra, note 23 at 1486.
402 Ibid. at 1491.
403 Blair, supra, note 107 at 240.
404 Ibid. at 241.
405 Ibid.
Given the discussion earlier in this chapter regarding the diverse human capital and other equitable investments in the corporation, and the interests at risk on insolvency, the adoption of an objective of enterprise wealth maximization flows neatly from recognition of these interests. Enterprise wealth maximization as a substantive objective of insolvency law can be effected under current insolvency and corporations statutory language. It necessitates recasting statutory obligations to "act in the best interests of the corporation" to reflect more clearly that explicit language. In other words, rather than define that best interest as the interest of shareholders for the solvent corporation and best interests of creditors for the insolvent corporation, "best interests of the corporation" would have regard for all those with investments at risk in the insolvent corporation.

In this respect, adoption of an enterprise value maximization objective would benefit traditional creditors, shareholders and other stakeholders. While traditional creditors' claims are fixed, they benefit from a viable restructuring plan from the increased likelihood that their claims will be fully satisfied.\(^4^0^6\) Where the workout involves conversion of debt to equity, creditors will also benefit from any value generated over and above existing fixed claims. This goal can also enhance decision-making in the firm, because those with investments at risk would have greater incentive to co-operate and facilitate decision making. Enterprise wealth maximization as an objective could encourage efficient production through enhanced use of informational and organizational capital, reduced information asymmetries and thus agency costs, and through encouragement of agreement among diverse interests. It could also discourage opportunistic behaviour and minimize loss on firm failure.\(^4^0^7\) Lin also suggests that directors should maximize enterprise value independent of what shareholders or creditors would independently advocate, because maximizing firm value will minimize losses associated with business failure or financial distress and reduce the overall cost of capital.\(^4^0^8\)

\(^4^0^6\) Lin, supra, note 23 at 1497.

\(^4^0^7\) Ibid. at 1500.

\(^4^0^8\) Ibid. at 1487.
i. *Directors to Act in the Best Interests of the Corporation Having Regard to the Investments of All Stakeholders*

Adoption of an enterprise wealth maximization objective also requires a mechanism to ensure that managers simply do not become unaccountable, justifying each decision based on the interests of any particular stakeholder. This is accomplished by recasting fiduciary obligations to take account of all those with investments in the firm, including shareholders, traditional creditors, workers and other stakeholders with equitable investments.

For the solvent corporation, it has increasingly been acknowledged that the manager/shareholder paradigm of governance has failed to recognize that many parties in addition to shareholders have an interest in the success of a corporation. Creditors and workers have firm specific investments and varying degrees of claims, both fixed and residual, depending on their arrangements with the firm and on its solvency. The closely held nature of Canadian corporations has resulted in close alliances of controlling shareholders and managers. The traditional view of the separation of ownership and control is that shareholders try to align the objectives of management with their own in order to reduce the risk of managerial opportunism. In the Canadian context, their interests are already closely aligned and the challenge is to reduce the risk of decision-making in the interest of those shareholders to the detriment of minority shareholders,

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409 Often managers' own at-risk assets are relatively small; Blair, *supra*, note 107 at 3. However Barton suggests that this is less the case with managers of closely held Canadian corporations. R. Barton, *supra*, note 355 at 2-3.

410 A study by the Ontario Teachers' Pension Plan found that a substantial percentage of directors of Canada's largest public companies have significant amounts of their own wealth at risk; more than 43% had greater than $100,000 worth of shares at risk in the enterprise. Barton, *ibid.* at 17.
creditors, and workers as human capital investors. In the insolvency context, this raises the question of whether directors effectively govern the corporation during negotiations for restructuring when their interests are so closely aligned to shareholders and yet they are ultimately accountable to creditors to make decisions that do not deplete their claims to the value of the assets.

Issues for publicly traded companies differ somewhat notwithstanding the fact that the majority of Canadian publicly traded companies are still closely held. The difficulty with decision-making as a corporation approaches insolvency is that trading values can be volatile during periods of uncertainty about governance of the corporation and its future. Suspension of trading assists this in part, but is at best a very temporary measure that does not address governance issues during the restructuring period. Where possible, ensuring that key creditors are supportive of the restructuring application prior to filing becomes significant. This may stabilize prices as well as reduce transaction costs.

Much of the governance debate has addressed the accountability gap between managers and shareholders. Normative assumptions that directors and officers are exclusively accountable to shareholders in terms of wealth maximization have been bolstered by the remedial provisions of corporate and securities statutes which legislate requirements for accountability and fiduciary duties to shareholders in the solvent corporation. In

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412 Daniels and Waitzer report that only 14% of corporations trading on the Toronto Stock Exchange are widely held. 60% are controlled by a single shareholder or group of shareholders with legal control, and more than 25% are controlled by a single or small group of shareholders with effective control. Ronald Daniels and Edward Waitzer, “Challenges to the Citadel: A Brief Overview of Recent Trends in Canadian Corporate Governance” (1994) 23 C. B. L. J. 23 at 24.


414 The corporate statutory regime is aimed at imposing a duty of care on directors and officers in order to safeguard against self-dealing transactions, as well as structuring rights and limitations on shareholder participation in decisions of the corporation. Daniels and Waitzer, supra, note 412 at 28. M. Priest et al, Directors’ Duties in Canada: Managing Risk (Toronto: CCH Canada Limited, 1995).
addition, remedial statutes provide suppliers, creditors, employees and the community with remedies against particular behaviour that is considered contrary to public policy.\textsuperscript{415} This regulatory scheme has a profound effect on our economic system, and on how corporations and stakeholders contract and interact.\textsuperscript{416} Directors and officers are governed by a whole regime of statutory and common law duties requiring them to act honestly and in good faith with a view to the best interests of the corporation, and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.\textsuperscript{417} Best interests of the solvent corporation have, however, been interpreted as acting in the best interests of shareholders.\textsuperscript{418}


\textsuperscript{416} R. Coase, "The Institutional Structure of Production" (1992) 82 Am. Econ. Review 713 at 717.

\textsuperscript{417} Nominee directors can consider the interests of their appointing shareholders, but have an obligation to act in the best interests of the corporation. \textit{OBCA}, supra, note 415, section 134. The \textit{Alberta Business Corporations Act}, R.S.A. 1980, c. B-15, s. 117(4), specifies that directors can give special but not exclusive consideration to the interests of its appointing shareholders.

However, the shareholder wealth maximization paradigm breaks down when the corporation becomes insolvent. While the loyalties of directors and officers are often still directed towards a shareholder-centred notion of best interests of the corporation, in reality there is no equity remaining. Creditors, particularly secured creditors, can lay claim to value from the residual assets of the firm and yet their interests are often not taken account of by directors and officers of the insolvent corporation other than in the narrow sense of settling fixed claims. Yet they have become the residual claimants and thus there is now an expectation that if they are to continue to invest, the value of their claim should be enhanced if there is a successful turnaround of the corporation.\textsuperscript{419}

Elsewhere I have suggested that current theoretical approaches to governance of solvent corporations ignore the normative implications of defining efficiency in terms of wealth maximization of shareholder interests.\textsuperscript{420} Concepts of property, maximization of shareholder wealth, and efficiency goals are deeply embedded in our collective consciousness, and thus are rarely articulated as normative concepts. As a result, they are rarely questioned as the underpinnings of current theories of corporate governance. Yet their normative invisibility does not render their normative content non-existent. For example, the contractual relations discourse assumes as a normative starting point that the owners of capital are free to externalize the costs of injury or adjustment from restructuring.\textsuperscript{421} It is possible, however, to supplement the underlying normative context in which corporations operate with concurrent objectives of equitable and safe workplaces as obligations arising out of workers’ human capital investments. Just as maximization of shareholder wealth and efficiency are normative assumptions, so too should there be a normative assumption that by virtue of their human capital investment in the firm, workers are entitled to protection from, and remedies for, particular harms to that investment inflicted by the corporation or its managers. The goal of maximization of

\textsuperscript{419} In terms of the capital loss not being recovered through a liquidation and putting the value to higher uses, then they may wish to negotiate for governance change such as seat on the board, or some provision such as the issuing of preferred shares as part of their continued investment.

\textsuperscript{420} Sarra, supra, note 27 at 45.
shareholder wealth, should, as a normative objective, be balanced with goals of equity in employment, safe workplaces, elimination of discrimination, and compensation which reflects workers' human capital investments. These objectives can be justified on efficiency grounds, if efficiency is recast to encompass an interest in the long-term viability of the corporation, not merely enhanced short-term shareholder value, as well as an objective of enterprise wealth maximization.\textsuperscript{422}

The case for insolvent corporations is even more compelling. Governance of insolvent corporations needs to take fuller account of all the investments at risk in the corporation. The notion of "best interests of the corporation" needs to be recast to reflect the interests of traditional creditors, workers and other stakeholders. In this respect, the fiduciary obligations of directors and officers must reflect an expanded notion of decision-making that takes account of multiple investments in the firm. McDaniel suggests that the definition of fiduciary obligation must require fair dealing with all investors in the corporation, arguing that fiduciary duties should run to both debt and equity claimants.\textsuperscript{423}

I am not suggesting that best interests of the corporation merely shift from a shareholder-centred paradigm to a creditor-centred paradigm at the point the corporation is insolvent. At that point, the interests of stakeholders have already been seriously compromised. If my claim is accepted that governance of solvent corporations should take account of all investments at risk in the firm, then effective governance could act to prevent insolvency. Accountability to and participation by workers, creditors and other stakeholders in the


\textsuperscript{423} McDaniel, supra, note 10 at 222, 206, 250; see also Coleman, "Efficiency, Utility and Wealth Maximization" (1980) 8 Hofstra Law Review 509 at 512. Shareholders keep gains from a corporate control transaction subject to the constraint that other parties to the transaction are at least as well off as before the transaction, citing Easterbrook and Fischel, "Corporate Control Transactions" (1982) 91 Yale Law Journal 698.
appropriate circumstances could enhance decision-making in advance of reaching insolvency.

Arguably, secured creditors already influence the governance of corporations because of the covenants they negotiate in their various debt instruments.\textsuperscript{424} However, absent insolvency, there are few mechanisms through which these creditors can gain decision rights when the firm starts experiencing financial problems but is not yet insolvent. Most recently, courts have recognized the rights of creditors to seek remedies under the oppression provision of corporations statutes. As the corporation approaches insolvency, absent the willingness of the debtor corporation to co-operate privately, the creditor must wait for certain default events before it can take action which ultimately gives it a role in governance or negotiations for a workout. Similarly, absent corporate governance reform for other stakeholders, there are few avenues to influence corporate decision-making. By consistently casting the best interests of the corporation to take account of all investments, the interests of traditional creditors, shareholders, workers and other stakeholders would be taken into account, whether the corporation was solvent, was starting to have financial difficulties, or had reached the point of insolvency.

Arguably, such a definition of best interests could create accountability problems because directors could justify any decision based on some sort of stakeholder interest.\textsuperscript{425} This can be remedied by according traditional creditors, workers and other equitable investors the right to challenge decisions based on fiduciary obligations under corporation’s statutes. The thresholds set by the courts \textit{vis a vis} fiduciary obligation to shareholders and deference to business judgements could then be applied to these other parties with access to oppression remedies.

\textsuperscript{424} Scholars such as Lin argue that traditional creditors are best able to assess risk and monitor managers because they have lower information and coordination costs, \textit{supra} note 23 at 1503.

\textsuperscript{425} This has been the criticism of the American “Constituency Statutes” in which directors can consider and act on the interests of constituencies other than shareholders. However, Lipton and Rosenblum have suggested that these statutes do allow directors to consider the interests of the corporation as a business enterprise rather that just the interests of shareholders. M. Lipton and S. Rosenblum, “A New System of Corporate Governance: The Quinquennial Election of Directors” (1991) 58 U. of Chicago Law Review 187.
The recent successful use of oppression remedies by creditors is the first step in this direction. In *Peoples Department Stores*, the directors of the bankrupt corporation were found personally liable to creditors and shareholders in failing to exercise their duty to act in the best interests of the corporation and its creditors. The Court held that where the corporation is insolvent or near to insolvency, directors duties lie not only to shareholders, but they are bound to act in the best interests of the corporation's creditors. The Court further elaborated on the availability of the oppression remedy for creditors in *Enterprise Capital Management* by holding that in order to establish oppression there must be evidence before the court that the affairs of the corporation have been conducted in a manner that is oppressive, unfairly prejudicial or unfairly disregards the interests of the creditor or complainant. Thus the finding of a fiduciary obligation does not fetter the ability of the corporation to make decisions, it merely ensures that that decision-making is not oppressive, unfairly prejudicial or unfairly disregards creditors' interests. A similar standard could apply to the stakeholders that I have described in this chapter.

Moreover, if fiduciary obligation was interpreted in this way, shareholders and managers would be more likely to reduce the risk of such challenges to their decisions by according stakeholders decision or participation rights on boards of directors, workers' councils or other accountability mechanisms. In turn, this could enhance governance of the corporation. The obligation of directors to maximize enterprise value could also reduce the cost of capital by lowering the agency cost of debt, because it lowers the risk of

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428 Ibid.

429 *Enterprise Capital Management v. Semi-Tech Corporation* (5 May 1999) (Ontario Superior Court of Justice (Commercial List)) at paragraph 28, Ground J. The Court held that it is not enough that the creditor establish that its security has been negatively impacted.
shareholder and manager opportunism, and thus both monitoring costs and risk of non-payment. Workers would now have the information as well as the organizational capital to better monitor the actions of managers.

If one is to adopt a framework that affords much broader consideration of interests and enhanced participation, decision or control rights, a key question is how to reconcile these rights with existing traditional creditor rights.

F. Principles for Reconciling the Rights of Traditional Creditors with Other Stakeholder Interests

My conceptual framework has thus far avoided a discussion of the "public interest" other than to concur with the public policy recognition that it is important to encourage corporate restructurings where it is likely that parties can come to some agreement on a viable business plan. The notion of the public interest is a nebulous and troublesome concept. As discussed in chapter 3, judicial pronouncements to date have largely avoided defining the public interest, although it is increasingly used as the rationale for particular decisions by the courts.

However, I have concluded that in the context of insolvency law, "public interest" is essentially a short form means of communicating the complex balancing of diverse interests that the court undertakes. As discussed at the outset of this chapter, those interests diverge and converge based on the particular circumstances. When courts refer to the public interest, they are referring to the balancing of multiple interests, some of

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430 Agency costs include costs of monitoring and enforcing debt; reduced profits by limits placed on debt covenant to restrict managers' decision making. Lin, supra, note 23 at 1499.

431 See the discussion of Algoma Steel, infra, Chapter 5.
which are represented in court before them and some of which are not, for reasons discussed above. Arising out of this balancing and out of the collective experience of insolvency proceedings over the past decade, the courts have distilled several principles that are in the “public interest”, i.e. recognizing the types of loss of investments resulting from firm failure and maximizing the value of the greatest number of interests involved in the insolvent firm. Thus it is in the public interest to avoid premature liquidations and restructuring schemes are a valuable mechanism to prevent this. It is in the public interest to protect the claims of various stakeholders such that there is not a race to enforce individual claims to the detriment of other claimants. It is in the public interest to respect the statutory allocation of priority of claims while still allowing parties the opportunity to determine whether they should compromise or defer those claims in anticipation of generating greater value in the long-term. It is in the public interest to enhance access to information about the insolvent firm in order to allow for informed negotiations for an optimal solution. It is in the public interest to generate economic activity, including preservation of both creditors’ and human capital investments. Thus, references to the public interest are the short form for referring to all of these interests.

Complex relationships, multiple remedial statutes and interests beyond traditional creditors and shareholders are all part of the public interest. As Edwards observed more than fifty years ago in discussing the then new CCAA, the court in rendering an informed judgment must consider all of the interests involved in the firm because restructuring involves interests beyond shareholders and creditors, including workers, minority creditors and the public. Public interest thus signifies that having balanced all the interests at stake, the court has an equitable judgment to make.

Once this is understood, the question is how to ensure that the systems framework both protects and reconciles traditional creditor and other stakeholder interests. I discuss two ways in which this is accomplished. First, I suggest that the framework proposed does

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432 Edwards, supra, note 46 at 601, 614.

433 Ibid.
not substantially compromise traditional creditor rights. Second, there is a role for the judiciary to play in reconciling interests, although this role is circumscribed by other substantive requirements in the legislation.

My framework does not require any statutory amendments. There are, however, some basic principles for reconciling of stakeholder interests. First, ultimately the plan or proposal needs the support of traditional creditors because of the need for new capital to carry on operations and because of the statutory voting requirements. Thus, creditors’ rights are preserved. Second, the existence of substantive rights under the insolvency and bankruptcy statutes gives traditional creditors considerable bargaining power because the statutory scheme requires creditors’ support of the plan by class majority and by 2/3 value of claims. Thus there will be some balancing and reconciliation of competing claims within the debtor corporation, not leaving these issues entirely to the formal negotiation and voting process. Third, just as the stay acts to suspend enforcement rights of creditors, it can also be viewed as a temporary suspension of control rights, affording more opportunity to obtain and effectively use the informational capital from the stakeholders as equitable investors. Finally, definitions of class can be used to accommodate a spectrum of participation and voting rights.

i. Framework Continues to Substantially Support Traditional Creditor Rights

Few would dispute the fact that any systems approach to insolvency must continue to protect the rights of traditional creditors and respect the overall scheme of bankruptcy
that creates a priority in the enforcement of claims. This scheme allows parties to undertake risk assessment and investment decisions with some certainty about their rights and priorities on firm failure. It preserves incentives to lend money and thus ensures the future availability of credit. In turn, this will avoid premature liquidation in order to ensure protection and enforcement of claims.

Traditional creditor rights can be reconciled with my proposals for recognizing stakeholder rights to participation and decision-making. On insolvency, the debtor company determines whether it would be beneficial to file an application for a proposal or plan in which the corporation restructures its debts and often its share structure, and develops a business plan that would allow it to become solvent again. The debtor corporation applies for the protection of the court, and an initial stay is granted either with approval of the court in a CCAA application or automatically under the BIA for a maximum of thirty days. The stay acts to suspend particular rights of all parties with claims to the value of the corporation’s assets pending the development by the corporation of a proposal, plan of compromise or arrangement. The purpose of the stay is to afford the corporation time to negotiate a plan acceptable to creditors. Creditors’ rights to enforce claims are thus temporarily suspended during the stay period so that the debtor corporation can direct its resources towards development of a plan instead of proceedings in which creditors are seeking to enforce their claims. Ultimately, the statutes require substantial support by the creditors if a plan or proposal is to be sanctioned by the court.

If a restructuring is likely to result in creditors receiving more than the value they would receive if the corporation was liquidated today, this is a first threshold in meeting a restructuring hurdle. Beyond that, however, the framework contemplates, if not unanimous, certainly high buy-in from the creditors of any proposed plan. Creditors must determine that the forgone liquidation value today is likely to be worth the restructuring, possible revitalization of the firm, and future satisfaction of their claims.

\[434\] Although the precise order of priorities is legitimately the subject of considerable debate.
My proposed framework does not substantially injure these rights. Creditors would continue to have the right to vote for or reject the proposed plan, and failure of the debtor corporation to secure support for the plan in the amount specified by the legislation will result in the plan failing, most often resulting in receivership proceedings. This is what Triantis has called the “guillotine” affect in that it provides creditors with a timely means of enforcing their claims when a workout is not accomplished. Recognition of greater stakeholder participation would require some additional transaction costs because the negotiations would involve more parties and more interests. However, as noted above, creditors do not currently bear the full costs of negotiations for workout. While they pay indirectly through the corporations’ resources being directed at restructuring instead of satisfying claims, this is offset by the value that may ultimately be generated by implementation of an effective plan or proposal. All parties may ultimately profit from a restructuring plan that has the benefit of much more informational capital and high support from workers and local governments.

The second key aspect of the existing conceptual framework is the protection of creditors’ interests in the firm’s assets during restructuring. The framework imposes on the debtor corporation a number of obligations to ensure that creditors’ interests are not prejudiced during the stay period. This reinforces the larger scheme of secured transactions, bankruptcy and insolvency law that permits the registration and enforcement of creditors’ claims in a regime in which they are given specific priority both in and outside of bankruptcy. In this respect, the framework is very creditor focused. This is because in most cases of corporate insolvency, shareholders have little if any equity remaining in the corporation. Thus, the objective is to recognize and try to maximize the value of those whose investments are now at greatest risk, i.e. the creditors. Given that my proposals do not require statutory amendment, these rights are also preserved under my proposed framework.

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435 Triantis, supra, note 1 at 101-2.
436 See discussion in Chapter 3 regarding the current regime.
A further question is whether the costs of negotiating any surplus that would be generated by a successful workout are worth the benefits, necessitating some sort assessment of the costs and benefits of such a negotiation process. The highly inefficient corporation, which has no chance of survival, should not survive. This, most scholars and practitioners would agree, is not the purpose of insolvency law. The costs of negotiating a restructuring plan should be part of the assessment in determining whether to proceed. However, the determination of whether the firm should survive is a multi-dimensional determination and involves interests beyond traditional creditors. It is not purely a question of whether the corporation is worth more to creditors in their own hands or the hands of third parties. It involves considerations of where the corporation is situated, the impact on communities, the need to maintain goodwill, the activism of workers, and a host of other economic and social considerations. Practitioners have suggested that secured creditors often do not want to be the party that “pulls the plug” on the firm, particularly in communities where the firm is highly dependent on a single firm or industry. This is because of the potential for loss of goodwill and future debtors. The reasoning of these creditors is more complex than merely an assessment of the assets put to best use.

Moreover, the range of stakeholders who have investments at risk may have everything to do with the question of which solution will generate the greatest return to satisfy the claims of creditors. For example, workers or local governments may have the greatest incentive to try to negotiate a workout because the potential economic loss on firm failure is far greater for the community than their fixed claims would indicate. The long-term losses to jobs, community stability, and municipal tax bases are not measured in a simple debt collection regime. Nor does it take account of the incentives for these stakeholders

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437 Jackson argues that “piece-meal liquidation”, which is the usual standard by which the claims of creditors are assessed and against which the reorganization proposal is measured, is an inappropriate standard. Instead, he argues that the proper assessment is the difference between the value of the assets put to their best use in third party hands, compared with the value of the assets in the hands of pre-bankruptcy claimants. Jackson, supra, note 129 at 215.

438 Fred Myers, interview (12 January 1999).
to enhance the performance of the corporation to ensure that it becomes viable again. These are Posner and Kordana's "high-value" creditors in that their interest in the future of the corporation is much higher than other stakeholders. Creditors do sometimes take account of these factors without in any way compromising their ultimate rights to enforce. If traditional creditors can recognize the value of workers' past and future contributions to the firm, their interests may be recognized as congruent, as discussed at the outset of this chapter. Given that the hierarchy of claims is largely preserved, the recognition of participation and decision rights of equitable investors or stakeholders such as workers and local government does not substantially harm traditional creditors' rights.

ii. The Role of the Judiciary in Reconciling Differences

As with the court's current role in reconciling the interests of traditional creditors with those of managers and shareholders, the court has an important role in the reconciliation of differences under my proposed systems framework. The restructuring scheme must facilitate incentives for parties to develop and agree on proposals or plans that meet their economic interests. The role of the court is to ensure that the interests of workers and other stakeholders are recognized and considered. The role is not that the judiciary should dictate a particular outcome in the proceedings.

The court's role in this respect involves both procedural and substantive decision making, often with considerable overlap between the two. Much of that role is already undertaken in our current insolvency regime. The difference is that the court would facilitate the creation of a process to take into account investments and assets that have not traditionally been valued. Then it is left to the stakeholders, broadly defined, to negotiate and vote on a restructuring plan or proposal. Where particular issues cannot be resolved through the negotiation process, the judiciary engages in a balancing, looking to the

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\textsuperscript{439} Posner and Kordana, supra, note 191 at 165.
\end{quote}
views of the new residual owners of the value of the corporation's assets as much as possible.\footnote{Frost, \textit{supra}, note 202 at 91.}

At the end of the process, the judiciary cannot impose an outcome. Moreover, the court is unlikely to approve a proposal that does not enjoy the support of a substantial number of creditors.\footnote{The statute specifies that the plan must have the support of the majority of creditors in the amount of two-thirds the value in each class. Thus, this guides and restricts judicial decision making.} The court's task in sanctioning a particular restructuring plan is to ensure that the statutory requirements have been strictly complied with, to determine whether the materials files and procedures are authorized by the legislation, and to determine that the plan is fair and reasonable.\footnote{These are the tests currently used by the courts in sanctioning hearings under the \textit{CCAA}. See for example: \textit{Re Quintette Coal Ltd.} (1992), 13 C.B.R. (3d) 146 (B.C.S.C.); \textit{Olympia \\& York Developments Ltd. v. Royal Trust Co.} (1993), 17 C.B.R. (3d) 1 (Ont. C.J. (Gen. Div.) Commercial List).} The "fairness" inquiry, as is discussed in some detail in the next chapter, has involved a balancing of interests by Canadian courts. Here, the inquiry would be expanded to include a balancing of equitable investor interests in addition to the more traditional creditor and shareholder interests. It is not the role of the court to second-guess business judgments. However, these judgments are currently measured against a normative benchmark of maximizing shareholder interests for the solvent corporation and maximizing creditor value for the insolvent corporation. If the benchmark for assessing business judgment was enterprise value maximization, as discussed earlier, then the court's inquiry and any deferral to business judgment would be measured against this normative framework. Key is who has participated in determining the business decisions.\footnote{Frost suggests that this kind of decision making relies heavily on financial economics theory. Frost, \textit{supra}, note 202 at 91.} Currently, the court's assessment of the fairness of the plan is an assessment of whether the interests of the new residual claimants, the creditors, are met, recognizing the shift in interest and a balancing of equities in terms of the impact of
particular decisions.\textsuperscript{444} This would be enhanced by consideration of the equitable interests of those with fixed and residual claims.

In creating a process that more explicitly recognizes the equitable as well as fixed capital claims of investors, the court can make a number of procedural and substantive orders. The court can order particular participation and decision rights, by determining classes under the governing statutes, including determination of similarity of interest. The court can order disclosure to reduce information asymmetries. The court may be required to set timetables for interim decisions in order to ensure an expeditious resolution of the process. Through the granting or refusal of continuation of stay periods, the court can ensure that workers, local governments, tort claimants and other stakeholders are participants in the process. The court can address the issue of resources to participate by granting requests for the funding of representative counsel. Structuring of creditors' committees can ensure that broader interests are accounted for, can enhance monitoring, as well as facilitate greater buy-in by stakeholders of any plan ultimately developed.\textsuperscript{445} The court can authorize payments for professional advice, thus reducing the transaction costs for parties trying to accomplish this on their own. In turn, this will ensure more informed decision-making by all creditors and stakeholders.\textsuperscript{446} The court can set out cost sanctions for any bad faith efforts by parties in the negotiations for a workout. The court can order alternative dispute resolution processes in order to contain costs and expedite the workout process, or can itself utilize mediation skills in resolving issues between senior creditors and other stakeholders.

Through development of its caselaw, the court can provide templates or menus that would assist stakeholders who are new to the insolvency process or who are less


\textsuperscript{445} Ibid. at 118.

\textsuperscript{446} This could include such issues as calculating the value of pension surplus, the value of the firm at liquidation, determining the value of the assets if sold on a going concern or liquidated basis, and similar information.
sophisticated to understand the scope and possibilities for their participation and decision rights. The court could utilize its appointed officers, such as monitors and receivers, to perform tasks such as information reporting, development of restructuring plans, or mediating conflicts between investors, having regard for all of the investments at risk in the corporation.\textsuperscript{447}

Thus the role of the judiciary would be to continue to facilitate the objectives of insolvency legislation by ensuring a timely and informed resolution of issues in dispute between the parties. At the end of the day, if the senior creditors are not persuaded by the merits of a proposed plan or proposal, and the debtor corporation is not able to garner the requisite support, the scheme allows creditors to move to enforce their claims. My framework supports the existing creditor approval provisions of the statutory scheme. It merely requires that before that determination is made, there should be a full consideration of the costs, investments at risk, and restructuring potential of the insolvent corporation.

\textsuperscript{447} As is discussed in some length in chapter 3, the role of court appointed monitors and receivers has been to represent the interests of both the court and traditional creditors. This role could be expanded, under the advice and direction of the court, to have the court-appointed officers facilitate the involvement of workers and other non-traditional stakeholders with investments at risk in the process.
CHAPTER 3

APPLYING THE CONCEPTUAL FRAMEWORK TO THE EXISTING STATUTORY SCHEME FOR THE GOVERNANCE OF INSOLVENT CORPORATIONS

(The CCAA) plan represents the fragile balancing of a myriad of commercial factors- with each participant in the process “giving and getting” a complexly interwoven and, in some ways, indefinable exchange of economic interests.

Mr. Justice Blair, *Olympia & York* 448

Having set out a theoretical approach to restructuring and governance of insolvent corporations, in this chapter, I analyze how this framework applies to the current statutory scheme, specifically, who has voice in the current scheme and how are interests affected. Insolvency law has very recently begun to reflect some of the notions set out in chapter 2, but these notions need further conceptualization. I suggest that recognition of interests such as workers and communities in fact formed part of the historical development of the CCAA in terms of broad notions of “public interest”. This was then largely forgotten as was the CCAA generally for almost fifty years. With the re-emergence of the statute as a useful restructuring tool, the notion of interests broader than those of shareholders and traditional creditors has not, until recently, been accorded any value. I speculate on what accounts for the recent changes, using cases currently before the courts. This chapter sets the background for chapters 5 to 7, in which I examine in depth, three cases that represent the recognition, both procedural and substantive, of non-traditional creditors or stakeholders. In this chapter, I make constructive suggestions for the further development of the law, based on the conceptual framework developed in chapter 2.

448 *Re Olympia & York Developments*, supra, note 442 at paragraph 81.
A. Overview of the Statutory Regime of Insolvency and Bankruptcy

In Canada, since Confederation there have been more than a dozen statutes aimed at dealing with issues of commercial failure, insolvency and bankruptcy. As a result, there is considerable legislative and judicial experience dealing with what are often the competing interests of encouraging companies to restructure to become viable and protecting the secured and unsecured claims of creditors.

The first way in which an insolvent corporation can restructure its affairs is through a private workout. This is possible if there are few creditors or it is a closely held company. Use of a private workout as a mechanism to negotiate a compromise or arrangement does not necessarily signal to consumers or even trade suppliers that the corporation is in difficulty. It may facilitate the retention of key employees and distributors who might otherwise begin diversifying their risk by seeking employment or contracts elsewhere. Generally, private workouts are cheaper and faster than court-supervised processes. In part, it is precisely because there are fewer creditors, fewer transaction costs and fewer problems of collective action and negotiations. Practitioners have suggested that the rate of success of private workouts often bears a direct relation to the speed with which the debtor corporation presents a workable plan upon identifying that it is insolvent. However, in many cases of corporate insolvency, there are multiple creditors, often hundreds, sometimes thousands, and a private workout is not possible. Given that creditors are not prevented from seeking to enforce their claims during the private workout process, debtor corporations often seek the protection of court-supervised processes.

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449 Ziegel et al, supra, note 2 at 511.

450 Honsberger, supra, note 61 at C-5.

451 Ibid. at C-3

452 Ibid. at C-5.
The most critical Canadian statutes governing insolvency and bankruptcy are the Bankruptcy and Insolvency Act (BIA) and the Companies’ Creditors Arrangements Act (CCAA). The BIA is aimed at bringing uniformity to the administration and liquidation of bankrupt estates in Canada. The key underlying principle of the bankruptcy regime is that creditors should control the administration of the estate that has been placed into bankruptcy. This is because the liquidation of the estate is for the almost exclusive benefit of the creditors, and thus they are in the optimal position to ensure that their best interests are met. The BIA also sets a hierarchy for the satisfaction of claims, and companion statutes such as the Bank Act influence that hierarchy. The BIA and CCAA provide separate but complementary regimes for companies to make proposals or plans of arrangement or compromise, to structure their affairs to the satisfaction of creditors and with a view to becoming economically viable. Some corporations may choose which regime they will utilize, but the CCAA specifies that it applies only where there are claims against the debtor corporation or affiliated debtor companies in an amount exceeding 5 million dollars. While there has been considerable debate as to the necessity of two arrangement regimes in Canada, to date, the federal government has chosen to retain both the BIA and CCAA restructuring schemes. The recent amendments imposing a threshold of $5 million in debts for CCAA applications does indicate a legislative objective to limit somewhat the ability of debtor

453 BIA, supra, note 5; CCAA, supra, note 5. In addition, the Federal Winding Up and Restructuring Act, supra, note 5, provides for the liquidation of banks, insurance companies and trust companies. There are also provincial winding up statutes.
454 Ziegel et al. supra, note 2 at 523.
455 Ibid. at 523.
456 Bank Act, supra, note 305, section 427. There are also provincial debt collection statutes such as the Personal Property Security Act, supra, note 233 that influence the priority given to particular creditors.
457 Section 3(1), CCAA, supra, note 5. There is a separate regime aimed at allowing personal bankrupts to restructure their debts; this is not the subject of this paper, see Division II, Consumer Proposals, BIA, supra, note 5. Amendments to the BIA in 1997, s. 66(2) specify that notwithstanding the CCAA, proceedings commenced under the CCAA shall not be dealt with or continued under the BIA and that proceedings shall not be commenced under Part III of the BIA if a compromise or arrangement has been proposed under the CCAA and has not been agreed to by creditors or sanctioned by the court under that Act.
companies to forum shop. Thus the restructuring provisions of the BIA appear generally aimed at small to medium sized enterprises, whereas the CCAA is aimed at larger corporations or complex situations.

The third, less commonly used means of restructuring is use of the Canadian Business Corporations Act (CBCA) arrangement provisions. While government policy makers have expressed some concern about the use of corporations statutes in the restructuring of insolvent corporations because there already exists special legislation aimed at insolvency, the courts have endorsed the use of this tool. The principal reason for using the CBCA or other corporations statutes is to preserve equity for shareholders. Essentially, a precondition to use of the BIA or CCAA is that the corporation is insolvent and thus there is little or no equity remaining in the corporation. In contrast, the arrangement provisions of the CBCA require the corporation to be solvent. Thus, corporations statutes are used to try to preserve shareholder equity while preserving value for creditors. For example, in Dome Petroleum, Dome was clearly insolvent yet the proposed arrangement required amalgamations and debt exchanges, both of which were not provided for easily under the CCAA, even if the application had been brought

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458 In addition, one of the most significant changes is that there is no longer a need for a corporation to artificially create deemed trusts in order to qualify under the CCAA. This requirement which existed from the first enactment of the legislation until 1997 created considerable litigation in terms of access to the court’s protection under the CCAA, see for example, Elan Corporation v. Comiskey (1990), 1 C.B.R. (3d) (Ont. C.A.).

459 CBCA, supra, note 5.

460 See for example, the cases of Dome Petroleum, Trizec Properties and Unitel Communications in Ziegler and Baird, supra, note 6 at 617. The Director of the CBCA has expressed concerns regarding the use of the CBCA’s arrangement provisions for insolvent corporations. See Policy Statement of Director of CBCA (1994) 17 O. S. C. B. 4853, cited in S. D. Belcher and A.J. Kent, “The Restructuring of Unitel Communications Inc.” in Ziegler and Baird, supra, note 6 at 616-7.

461 Yet Tay points out that no similar rationale exists for sacrificing creditors rights, absent their consent outside of insolvency. Derrick Tay, “The Use of Corporate Legislation in the Trizec Reorganization: The Triumph of Substance Over Form” in Ziegler and Baird, supra, note 6 at 199. See also Simon Scott, “The Acquisition of Dome Petroleum Limited by Amoco Corporation” in Ziegler and Baird, ibid. at 301.

conjointly with a CBCA application. In Dome Petroleum, the applicant in the CBCA arrangement proceedings was a wholly owned subsidiary of Amoco Canada called Amoco Acquisitions. Amoco Acquisitions was solvent and thus fell within the criteria of the statute, although it was unclear whether all the corporations involved in the arrangement had to be solvent. Amoco Acquisition sought and received a declaration from the Alberta Court of Queen’s Bench that its proposed arrangement was an arrangement pursuant to the CBCA and that the Court had jurisdiction. After seeking direction from the Court on notice, service, disclosure and voting, it then proceeded to secure the support of creditors and shareholders and the endorsement of the Court. The corporation was then to be amalgamated with Dome and several other subsidiaries. The Court thus facilitated the plan of arrangement by liberally interpreting the arrangement provisions of the CBCA.

Often parties need to utilize more than one piece of legislation. For example, if there is a corporate reorganization at the same time as the restructuring of debt, such as amendments to share structure, these must be effected under arrangement proceedings under the applicable corporations legislation. There are no such provisions that permit a corporate reorganization under either the BIA or the CCAA. Moreover, where there are public shareholders, the courts have sanctioned mechanisms such as special committees of independent directors, hired specialized expertise and court ordered

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463 Scott, supra, note 461 at 300.

464 Ibid. at 311.


466 Ibid. Both matters were appealed unsuccessfully.

467 See the discussion in Olympia & York Developments, supra, note 442 regarding the mesh between corporations’ statutes and the CCAA. See also Dylex (4 May 1995) Court File No. B-4/95, (Ont. C. J. (Gen. Div.) Commercial List.) Houlden J.A..

468 This is because the federal government did not want to trench on provincial jurisdiction at the time it enacted the restructuring scheme. J. Latham, "General Overview of the Bankruptcy and Insolvency Act" (CBAO Conference, Toronto, 1998) at 6. See also section 192 OBCA, supra, note 415.
meetings of public shareholders to assist in determining the fairness of a proposed
arrangement.469

A key component of the Canadian restructuring scheme is the integration of federal tax
law given the tax impact of restructuring. A workout can, under either the BIA or the
CCAA involve conversion of debt to equity through mechanisms such as issuing of
distressed preferred shares.470 The issuance of distressed preferred shares qualifies for
special treatment under the Income Tax Act.471 Dividends received on the shares are tax
deductible in computing taxable income, thus providing a lower cost means of financing
a restructuring.472 This enhances the ability of the debtor corporation to service equity
financing at lower costs than debt financing, and creates tax benefits to investors
combined with the ability to preserve their security and priority. It thus allows insolvent
firms to offer incentives to investors, including existing creditors, who might not
otherwise be willing to provide additional financing.473 The public policy rationale for
this tax treatment is that the availability of tax incentives to convert debt to equity in the
form of redeemable preferred shares permits the lender to receive the dividends on those
shares on a non-taxable basis, thus facilitating the continued operation of the corporation
by reducing debt finance costs.474 The secured creditor benefits because it creates an
alternative to forcing liquidation, the debtor corporation benefits from continued

469 Olympia & York Developments, supra, note 11.

470 McLaren, supra, note 37 at 4.6600.


472 Income Tax Act. ibid. Distressed preferred shares are exempted from tax rules that deny inter-corporate
dividend deductions. This reflects public policy that financially distressed corporations should be given the
opportunity to restructure. To qualify, the corporation must be in financial difficulty. T. R. Burgoyne and
D. Tetreault, “The Distressed Preferred Shares: Restructuring with After-Tax Financing” (Insight
Conference, Toronto, 1992) at 2, 10.

473 There are a series of stringent tests that must be met first, although debtor corporations can receive
advance rulings from Revenue Canada. The problem is that these rulings can take time and time is of the
essence in restructuring proceedings, Haney, supra, note 248.

and 20. This is because preferred share dividends are set much lower rates than interest rates.
operations, and the other creditors are not prejudiced because there is no change in priority.\textsuperscript{475} The court has held that the issuance of such shares creates a mechanism to allow the restructuring of the debtor corporation to exchange debt for equity and reduce financing costs for a period not greater than five years.\textsuperscript{476} Restructuring in turn allows the insolvent corporation to restructure its financial arrangements in order to meet its current and future financial obligations and to carry on business with a view to turning around its affairs.

The objective of corporate restructuring systems is to preserve the corporation as a going concern notwithstanding the fact that it is financially distressed, if there is a prospect that it can become viable.\textsuperscript{477} By placing a stay on the ability of creditors to enforce their claims for a limited period, creditors cannot force the corporation into bankruptcy. The \textit{quid pro quo} of the stay is that any proposal, plan of arrangement or compromise must have the support of the majority of creditors in an amount of two-thirds of the value of claims in each class in order to receive the sanction of the court.\textsuperscript{478} Ziegel and Cuming point out that corporate restructuring comprises a small proportion of overall issues under the bankruptcy regime. For example, in 1994, there were 11,810 business bankruptcies and only 743 restructuring proposals under the \textit{BIA}.\textsuperscript{479} However, by 1998, there were nearly 9,000 restructuring proposals filed, the result of 1992 amendments stressing the survival of troubled companies over liquidation.\textsuperscript{480} With respect to the number of

\textsuperscript{475} \textit{Ibid.}

\textsuperscript{476} \textit{Ibid.} at paragraph 63.

\textsuperscript{477} George Triantis, "Keeping the Gates to Corporate Reorganization: Judicial Activism under the \textit{BIA} and \textit{CCAA}: Book Review" (1997) 28 C.B.L.J. 279 at 279.

\textsuperscript{478} A practice has developed before the courts of lifting the stay for limited time and reasons in order to allow creditors to file applications under the \textit{BIA}. The reason for this is to allow the timeframes to run for these parties should the restructuring efforts fail and the Company becomes bankrupt.

\textsuperscript{479} Under Division I proposals. That represents only 6\% of all bankruptcies. Ziegel \textit{et al}, \textit{supra}, note 2 at 761.

\textsuperscript{480} This figure includes small debtors. Over 90\% of these cases had assets and liabilities of less than one million dollars. S. Craig, "Lenders still cautious at this point in the cycle", Toronto Globe and Mail (3 May 1999) at B3.
arrangements or compromises under the *CCAA*, there appear to be no statistics. The Ontario Superior Court of Justice, Commercial List receives over 1500 cases per year, but it does not record how many of these are *CCAA* applications.\footnote{Although, the Registrar reports there are at least 10 cases before the Court at any given time. June Fraser, Registrar, Ontario Superior Court of Justice, Commercial List, interviews (6 January 1999) and (10 February 1999). Ziegel and Cumings, supra, note 2 at 761-3.} What is apparent, as noted in the introduction, is that these cases involve large and often complex restructuring, massive amounts of debt and thousands of workers.

While the bankruptcy and insolvency regime contains a rich legal history in terms of enforcement of claims and procedures by which individuals and companies are petitioned or otherwise put into bankruptcy, the focus of my conceptual framework set out in chapter 2 has been on one discreet aspect of the regime, specifically restructuring. This includes analyzing the governance issues that arise when corporations try to rearrange their affairs with a view to becoming solvent again. Here, I examine how the existing restructuring scheme operates and whether it can act to facilitate or hinder advancement of my ideas.

The objective of amendments to the *BIA* and *CCAA* since 1992 have in part been an attempt to create a system that is "fair, equitable and efficient for the parties involved".\footnote{American Law Institute, supra, note 33 at 4, 6.} In introducing the first major amendments to bankruptcy legislation since the 1940’s, the Government expressly stated that the objectives of the amendments were to better protect all marketplace participants, consumers, workers and companies, by better balancing debtor and creditor rights; by making rehabilitation rather than liquidation the focus of the legislation; by helping viable businesses better survive short-term downturns; by preserving jobs and by giving greater protection to unpaid suppliers and wage earners.\footnote{Honourable Pierre Blais, Minister of Consumer and Corporate Affairs, Remarks (Canadian Insolvency Institute Conference, Ottawa, 1991) at 1, 4.}
B. The Scheme of the BIA

While much of the focus in this thesis is on proceedings under the CCAA, it is important to place that discussion in the context of insolvency law generally in Canada. The Bankruptcy and Insolvency Act is the core legislation governing insolvency and bankruptcy. It is also the legislation that provides for consumer proposals to avoid bankruptcy, and affords smaller companies without complex ownership or debt arrangements a mechanism to develop proposals to restructure or compromise debts in order to avoid bankruptcy. Original bankruptcy legislation was aimed at providing a collective action mechanism against debtors and the evolution of the BIA as a rehabilitation statute dates as recently as the 1992 amendments to the legislation.\footnote{Register J.M. Ferron, Registrar in Bankruptcy, Ontario Superior Court, “Rehabilitation and Fresh Start, Concepts That Never Were” (CBAO Conference on Insolvency, Toronto, 1996) at 3, 8. The 1992 amendments to the BIA also increased the power to supervise receivers whether they are court appointed or privately appointed. Any creditors, debtor or trustee in bankruptcy may request the court’s supervision of a receiver. The receiver can also apply for advice and direction of court in regard to the administration of the property.}

Creditor is defined under the BIA as a person having an unsecured claim, a claim preferred by virtue of priority under section 136 or a secured claim, provable as a claim under the statute.\footnote{Section 2, BIA, supra, note 5. The 1997 amendments to the BIA changed the methodology for determining the date of bankruptcy by defining a “date of the initial bankruptcy event”. Robert Morris, “Implications of Recent Bill C-5 Amendments” (CBAO Conference, Toronto, 1997) at 2.} Section 136 sets out a scheme of distribution from the property of a bankruptcy, including funeral and testamentary expenses, expenses and fees of the trustee, legal costs, levies, wages and other compensation to workers in fixed amounts and for fixed periods, municipal taxes, arrears owing to landlords, amounts owing to workers’ compensation and income tax regimes, claims relating to injuries of workers not
covered by workers' compensation, and claims of the crown. Claims are defined under the statute as including “any claim or liability provable in proceedings under this Act by a creditor.” Thus the definition of creditor under the BIA is broad enough to encompass numerous interests, including the claims of contingent creditors. It does not, however, recognize the interests of those stakeholders who do not have direct capital claims on the assets of the corporation and for whom I proposed greater rights. Any consideration of such interests is undertaken by the courts in terms of reference to “public interest”, discussed below, not in terms of recognition of classes.

The scheme provides that secured creditors can privately enforce their claims by meeting statutory and common law requirements of demand, reasonable notice and notice of intention to enforce security. A creditor falls within the scope of the BIA enforcement provisions if the debtor is “insolvent” within the meaning of the statute and the collateral being enforced against by the secured creditor constitutes all or substantially all of the debtor’s inventory, accounts or other property used in a business carried on by the debtor. Under section 244 of the BIA, the secured creditor must send out notice of intention to enforce security, and absent waiver, must wait ten days after delivery of the notice of intention before it moves to enforce its security. The secured creditor who takes control of the assets becomes the receiver for purposes of meeting the statutory requirements. Alternatively, the creditor can appoint a receiver. This is a private remedy in which the creditor has fewer costs than a court driven process and the creditor controls most of the decision making. The receiver in this case is primarily accountable to the appointing creditor, although it is accountable to other creditors and the debtor company.

486 Section 136, BIA, supra, note 5.
487 Section 2, ibid.
489 Goldberg, ibid. at 3.
490 Where the collateral is in jeopardy, the creditor can apply to the court for appointment of an interim receiver before the s. 244 notice in order to protect the collateral for the ten-day period. Goldberg, ibid. at 4.
in the administration and disposition of assets.\footnote{Ibid. at 7.} Even though technically the privately appointed receiver is not required to acquire the consent of other creditors, sale of the assets at a price that is below the amount of secured claims could lead to claims by other creditors of improvident realization.\footnote{The Official Receiver, a federal government functionary, oversees any votes of creditors. See Latham, supra, note 468 at 3-5.} Thus practically speaking, receivers should be careful to consider the interests of all creditors.

The creditor can also seek a court-appointed receiver, which is generally more costly because of the requirement of court approval. Further, the receiver as an officer of the court is accountable to the court and to all other stakeholders, so that the moving creditor loses any control it may have had in the process. The obligation of the receiver is to act honestly and in good faith and to deal with the debtor’s property in a commercially reasonable manner.\footnote{Goldberg, supra, note 488 at 5.} The receiver may retain the existing officers and board of directors to assist in the effective disposition, making decisions with respect to how the corporation should be sold to satisfy the debts. Often the directors and officers have expertise and informational capital which the receiver does not. Their willingness to stay and co-operate may depend on their own equity stake in the corporation and on the availability of protection from further liability. Independent directors often resign from the board to prevent incurring additional personal liability.

The \textit{BIA} provides a regime for commercial proposals for restructuring, in order to allow an insolvent company an opportunity to restructure its affairs and become viable.\footnote{The \textit{BIA} defines insolvency as a debtor who has debts exceeding \$1,000 and who is generally unable to meet obligations as they become due, has ceased paying current obligations in the ordinary course of business, or where the assets at a fair valuation would not be sufficient to enable payment for all obligations. \textit{BIA}, supra, note 5.} Prior to the 1992 amendments to bankruptcy legislation, the statute could only effectively deal with reorganizations of unsecured debt. Any restructuring of debtor corporations

\begin{itemize}
\item \footnote{Ibid. at 7.}
\item \footnote{The Official Receiver, a federal government functionary, oversees any votes of creditors. See Latham, \textit{supra}, note 468 at 3-5.}
\item \footnote{Goldberg, \textit{supra}, note 488 at 5.}
\item \footnote{The \textit{BIA} defines insolvency as a debtor who has debts exceeding \$1,000 and who is generally unable to meet obligations as they become due, has ceased paying current obligations in the ordinary course of business, or where the assets at a fair valuation would not be sufficient to enable payment for all obligations. \textit{BIA}, \textit{supra}, note 5.}
\end{itemize}
with secured debt could not be accomplished under the *BLA* unless it was through negotiated settlement with secured creditors.\(^{495}\) Given that secured debt is important to the financing of corporations, any successful restructuring must have the support of and bind secured creditors in order for the corporation to successfully restructure.

Part III of the *BLA* specifies that any commercial entity can obtain a stay of proceedings against creditors for a limited period of time, in order to allow the company to develop a proposal of its debts to creditors.\(^ {496}\) The debtor files a notice of intention to make a proposal, which gives rise to an automatic stay of thirty days. The fact that the stay is automatic means that the debtor corporation does not incur the cost of seeking court approval and that it does not need the support of creditors at the outset of the process. It also means that the debtor corporation has no obligation to involve or consider the interests of non-traditional stakeholders during this period.\(^ {497}\)

In order for the debtor corporation to file a proposal, the proposal must first have been submitted to a licensed trustee in bankruptcy. The trustee files the proposal and a cash-flow statement with the Official Receiver, prepared and signed by both the debtor and the trustee. The filing triggers the automatic stay provisions. If the trustee has acted in good faith and takes reasonable care in preparing the cash-flow statement, it is not liable for

\(^ {495}\) American Law Institute, *supra*, note 33 at 10. Thus it was viewed as overly deferential to the claims of secured creditors. For example, prior there was no stay under the provisions of the *BLA* for secured creditors.

\(^ {496}\) Prior to 1997, the stay provision did not automatically apply to director liability in their capacity as directors of the corporation. Creditors can still seek an order that the provision does not apply if the creditor is likely to be materially prejudiced or on other equitable grounds. Morris, *supra*, note 485 at 9; section 69, *BLA*, *supra*, note 5. Proposal is defined in the *BLA* as including a proposal for a composition, an extension of time or for a scheme or arrangement, *BLA*, *supra*, note 5 at s.2. Composition is where creditors agreed to accept less than full repayment of debt owing to them. Arrangement is similar to that under the *CCAA*, usually comprising a restructuring of the corporation to alter rights of equity holder and classes of creditors, with arrangements as to the amount of debt to be repaid and the timeframe in which to satisfy such debts.

\(^ {497}\) See the discussion of the role of trustees at *infra*, part E of this chapter.
loss or damages resulting from reliance on the statement. In some cases, the court might appoint a second trustee to act as an interim receiver under the proposal, when it is necessary for the interim receiver to take control and undertake conservatory measures to preserve the estate for all stakeholders. This measure is taken when it is necessary to reassure creditors that the value of their claims is not being unnecessarily depleted. The trustee is obligated to give creditors a report on the reasonableness of the cash-flow statement, and it is responsible for convening a meeting of creditors within 21 days of the filing of the proposal.

Similarly, before filing a Notice of Intention to file a proposal, the debtor corporation must have the written consent of a licensed trustee who has agreed to act in the proposal. Once a Notice of Intention is given, the trustee must participate in the preparation of the proposal, and is obligated to advise and assist the debtor corporation. The extent of that advice and assistance is not clearly defined by the statute or the caselaw. The trustee must report periodically to creditors and to the court, as prescribed by the court or the regulation. The debtor corporation has an obligation to work in good faith and with due diligence to formulate a proposal. The trustee can apply to the court and establish that the debtor is not fulfilling these obligations or that creditors are materially prejudiced by the extension of stay. The trustee reports to the creditors’ meeting on the conduct of the debtor corporation, evaluation of assets, assessment of the liquidation value of the firm, on prior meetings with major creditors and the trustee’s involvement in the process. The trustee then makes recommendations to creditors about the viability of the proposal.

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498 Honsberger, supra, note 6 at C-16.

499 P. Casey and H. Reiter, “Commercial Proposals under the Bankruptcy and Insolvency Act” (Canadian Bar Association Conference, Toronto, 1996) at 3.

500 Ibid.

501 Honsberger, supra, note 6 at C-9.

502 The proposal must be accompanied by the cash-flow statement describing current and projected cash-flow.

503 Casey and Reiter, supra, note 499 at 6.
The debtor can seek extension of the stay from the court in up to 45 day increments to a maximum of six months in total. The court, in exercising its discretion to grant an extension, must be satisfied that the insolvent corporation has acted in good faith and with due diligence; that it would likely be able to make a proposal if an extension is granted; and that no creditor would be materially prejudiced by the granting of an extension. The tight time frame and maximum amount of stay means that the debtor corporation must act expeditiously to devise a proposal that is acceptable to creditors. A disadvantage is that the rigid timeframe can result in negotiations with only the largest creditors, in order to satisfy the minimum statutory requirement for creditor support.

Thus, the rule driven stay period militates against the involvement of broader stakeholder interests such as workers, local governments and small trade suppliers as I have proposed in chapter 2.

Under the BIA, a debtor corporation may make a proposal to creditors either before or after bankruptcy. The 1997 amendments to the BIA specify that a proposal may include terms for compromise of claims against directors with respect to claims that arose prior to the proceedings and that relate to the directors’ obligations in their capacity as corporate directors. The BIA also specifies that in addition to the debtor company, a receiver or liquidator, or trustee of the bankrupt estate can make a proposal. The inability of creditors or other stakeholders to make proposals is a negative feature of the

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504 Ibid.

505 Section 50.4(9), BIA, supra, note 5.

506 Ziegel et al, supra, note 2 at 525.

507 But not contracts between creditors and directors in their personal capacity and not where there is wrongful conduct. Section 50, BIA, supra, note 5.

508 For insolvent corporations this is accomplished under Division I proposals. Although Division I proposals are not restricted only to companies, that is generally what the provisions are aimed at. Division II proposals deal only with consumer proposals. In addition, Part X of the BIA allows consumer debtors to seek court approval for extension of time for debt repayment where debts are less than $1,000 or where the creditor consents. BIA, supra, note 5, section 50, Part X, Division I, II.
BIA scheme. Participation and decision rights such as those proposed in chapter 2 would be enhanced by the ability of stakeholders to be able to develop their own proposals.

When a proposal is developed and submitted to creditors, meetings of creditors are convened to vote on the proposal. For the proposal to succeed it must be accepted by a majority of creditors and two-thirds in value of the creditors present at the meeting. The 1992 amendments to the BIA revised the proposal regime to apply to secured creditors. A proposal accepted by creditors and approved by the court is binding on creditors in respect of all unsecured claims, and the secured claims in respect of which the proposal was made and that were in classes in which the secured creditors voted for acceptance in the statutorily required amount. The proposal does not, however, release the insolvent company from specified debts and liabilities unless the creditor consents.

If the proposal does not attract the required level of creditor support, a vote defeating it results in automatic bankruptcy. Practically speaking, however, where a meeting of creditors is held and there is general interest in finding an acceptable proposal, a "straw

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509 Ziegel & Baird, supra, note 6 at 525. Creditors can vote personally or by proxy.

510 Part III, Division 1, BIA, supra, note 5. Previously, it was a vote of unsecured creditors and did not bind secured creditors. This made the CCAA the preferred statute for the secured creditors. However, the BIA has now been amended to include secured creditors. There are four exceptions to the stay. A secured creditor to whom a proposal has not be made is not prevented from dealing with its security. Second, if the secured creditor already took possession of secured assets prior to the filing of the notice of intention, it is not stayed. Third, if the secured creditor gave s. 244 Notice of Intention to enforce security more than 10 days prior to the filing of the notice of intention or filing of proposal, it is not stayed. Finally, if the secured creditor was included in the proposal and voted against it, it can proceed to deal with the assets covered by the security in accordance with the loan agreement. Casey and Reiter, supra, note 499 at 10.

511 By a majority in number and two-thirds in value of the secured creditors present or represented by proxy and voting on the resolution to accept the proposal. If the proposal is made after bankruptcy, the court's approval operates to annul the bankruptcy, and to vest the bankrupt property in the debtor or any other party the proposal and/or the court directs. Ibid. at 525.

512 Section 178, BIA, supra, note 5, including awards of damages in civil proceedings in respect of bodily harm intentionally inflicted, sexual assault, or wrongful death as the result of these; any debts from alimony or spousal or child maintenance; and any liability for harms arising out of such actions as fraud, embezzlement or misappropriation.
vote" is taken of the classes of creditors and if the requisite support does not exist, the parties attempt some renegotiations of the proposal. This is so that a failed "official vote" does not automatically result in bankruptcy. If a class or classes of secured creditors reject the proposal, there is no deemed bankruptcy, rather the secured creditors are free to exercise their rights under their security without further regard to the proposal proceeding. Although the proposal does not require the approval of secured creditors, given that they hold first rights to the property of the corporation, realistically their approval is necessary because enforcement of security by significant secured creditors will render a proposal unworkable. As a result, proposal approval is often expressly conditional on acceptance of the proposal by all classes of secured creditors.

The approved proposal effectively becomes a contract between the company and its creditors, breach of which will give rise to bankruptcy. If accepted by creditors, the court examines the proposal to ensure that it meets the statutory requirements, and if appropriate, the court gives its approval. The court must be satisfied that the terms of the proposal are reasonable, are in the best interests of the general body of creditors, and that the debtor has not committed a bankruptcy offence. The statute also specifies that the court shall not approve the proposal where the assets of the corporation are not of a value equal to 50 cents on the dollar of unsecured liabilities, although the court may provide for a lower percentage where it is satisfied that the debtor did not cause the deficiency. If not, the statute specifies that a bankruptcy occurs.

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514 Casey and Reiter, supra, note 499 at 7.
515 Ibid.
516 Latham, supra, note 468 at 6.
517 Re Eagle Mining Ltd. (1999), 42 O.R. (3d) 571 (O. C. J. (Gen. Div.)); Re Aquatex Corporation (9 December 1998) Alberta Court File No. 69628 (Alta Q. B.), Bielby J.. Bankruptcy offence is a defined term in the BIA. The court will also hear the submissions of dissenting creditors before sanctioning the proposal.
518 Section 59, BIA, supra, note 5; Re Eagle Mining, ibid. In that case, the Court held that in considering whether to sanction a proposal, it would hear from a creditor who had voted in favour of the proposal but
bankrupt company, the inspectors must approve a proposal, since court approval of the proposal operates to annul the bankruptcy.\textsuperscript{520} In Canada, as in the United States, there are separate regimes for reorganization of financial institutions, railways and municipalities.\textsuperscript{521}

Thus, while the proposal provisions under the \textit{BIA} afford a less costly and expeditious mechanism for development and approval of a restructuring, its rule driven features create barriers to adoption of my conceptual framework. Features such as automatic bankruptcy upon certain events means that debtor corporations are more likely to focus exclusively on negotiations with traditional creditors in order to arrive at an acceptable proposal. It would be difficult to import stakeholder participation and decision rights into this scheme, other than greater use by workers and governments of any existing statutory creditor rights they have.

\textbf{C. The Scheme of the \textit{CCAA}}

The \textit{Companies' Creditors Arrangement Act} is a companion statute to the \textit{BIA} aimed solely at providing a scheme for restructuring of insolvent corporations.\textsuperscript{522} As with the \textit{BIA}, restructuring can include amending terms of existing debt, such as rescheduling principal repayment, extending maturity dates, altering interest rates or forgoing a portion of the interest or principal owed by the debtor corporation. It also allows the corporation to restructure in such a way as to allow parties to participate (based on some sort of proportional basis) in the value generated by the company as a result of the

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\item subsequent altering its position because of a significant change in circumstances, or hear the concerns of interested creditors in order to form an opinion as to the reasonableness of the proposal.
\end{itemize}

\textsuperscript{519} \textit{Ibid.}

\textsuperscript{520} McLaren, \textit{supra}, note 37.

\textsuperscript{521} Ss. 2, 50, \textit{BIA, supra}, note 5; Ss. 2, \textit{CCAA, supra}, note 5; section 109(b) U.S. \textit{Bankruptcy Code, supra, note 83. Winding Up and Restructuring Act, supra, note 5.}

\textsuperscript{522} \textit{CCAA, supra, note 5.}
reorganization and going concern value generated from it.\textsuperscript{523} The court's role is one of judicial oversight of the process.

The \textit{CCAA} applies only to corporations incorporated in Canada, and companies having assets or carrying on business in Canada, wherever incorporated.\textsuperscript{524} An application for restructuring under the \textit{CCAA} is restricted to corporations with at least $5 million in debt.\textsuperscript{525} Whereas the \textit{BIA} is largely rule driven, the \textit{CCAA} is a short statute and the framework has developed under the court-supervised process through judicial direction. The parties can thus fashion their own restructuring process to best suit their particular needs, subject to the court's approval.

The courts have often specified that the purpose of the statutory regime set out in the \textit{CCAA} is to facilitate compromises and arrangements between companies and their creditors.\textsuperscript{526} Court ordered stays on secured creditors (unlike the \textit{BIA} prior to 1992) made this an attractive forum in which to seek restructuring. The courts thus filled a void in the restructuring scheme. The history of the \textit{CCAA} has been an evolution of judicial interpretation and the courts have held that its design and efficacy is that it is a flexible instrument for the restructuring of insolvent companies.\textsuperscript{527} The \textit{CCAA} creates a process

\textsuperscript{523} Edwards, \textit{supra}, note 46 at 596.

\textsuperscript{524} Section 2, \textit{CCAA}, \textit{supra}, note 5.

\textsuperscript{525} The minimum requirement of $5 million in debt was an amendment to the \textit{CCAA} in 1997, section 3(1), \textit{CCAA}. \textit{ibid}.


whereby a debtor company is permitted an opportunity to find its way out of financial difficulty and thus avoid receivership or bankruptcy.528

The definition of creditor is reasonably broad and mirrors somewhat the language of the BIA. Secured creditor is defined in the CCAA as a holder of a mortgage, hypothec, pledge, charge, lien or privilege on or against, or any assignment, cession or transfer of, all or any property of a debtor company as security for indebtedness of the debtor company, or a holder of a bond secured by any of these whether or not the holder or beneficiary resides in Canada, and any trustee under any trust deed or instrument securing any such bonds.529 Unsecured creditor is defined in the CCAA as any creditor of the company that is not a secured creditor, and a trustee for the holders of any unsecured bonds issued under a trust deed or other such instrument.530 Thus, the statutory definitions of creditors are very expansive, and as will be illustrated in chapter 7, have been interpreted to include tort claimants as contingent creditors.

Both the courts and legislators have recognized that there are devastating social and economic effects of bankruptcy and liquidation because shareholder investments are destroyed, unemployment creates hardships on workers, and creditors recover little of their claims.531 Thus, the CCAA regime has allowed the principals of debtor companies and their creditors, under supervision of the court, to attempt to reach a plan of arrangement or compromise under which the corporation can continue its operations to the benefit of both creditors and the debtor corporation.532

528 Houlden and Morawetz, supra, note 7 at 50.
529 Section 2, CCAA, supra, note 5.
530 Section 2, ibid. Similarly, the trustee is an unsecured creditor for purposes of the Act except that the trustee does not have the right to vote at a creditors' meeting in respect of the bonds.
532 Ibid.
Either the debtor corporation or a creditor can make the initial application for a stay or propose a plan of compromise or arrangement. The purpose of a stay order under proceedings pursuant to the CCAA is to maintain the status quo for a specified limited period of time so that the debtor company can develop and present a proposed plan to its creditors for their consideration. Unlike the BIA, the stay is not automatically effected against directors, but the statute provides for it and this is routinely set out in the initial order. The statute allows insolvent corporations to carry on business in a manner that allows time to undertake discussions with creditors and to attract outside investment and enables it to prepare, file and seek approval from creditors and ultimately the court of a proposed plan of compromise or arrangement. Much of the language and process for approval is the same for the CCAA and the BIA. The initial stay is for 30 days. The court has held that the granting of any additional stay of proceedings will be based on the court’s assessment of whether the debtor company has acted and continues to act in good faith and with due diligence, and whether circumstances exist that make the extension appropriate. In particular, the court will assess whether a company has worked diligently and in good faith towards the development of a plan to present to creditors for their consideration. Generally, approval of the creditors is not a

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533 For example, in Cadillac Fairview, it was Whitehall Street Real Estate Ltd. Partnership, a U.S. "vulture" fund that made the CCAA application on December 19, 1994. The corporation did not hear about the application under after the initial order was made. Goldberg, supra, note 488 at 48.


535 The same exceptions apply as are set out in the BIA, s. 11.5, CCAA, supra, note 5; Morris, supra, note 485 at 12.

536 Morawetz, supra, note 3 at 35.

537 The 1997 amendments also allowed for the compromise of claims against directors in their capacity as directors of the corporation. Morris, supra, note 485 at 12.

538 Including the requirements for majority voting of classes and the initial stay period of 30 days. Latham, supra, note 468 at 5.

539 CCAA, supra, note 5 at s. 11(6); Re Starcom Service Corporation (1998) [B.C.J. No. 506] (B.C.S.C.).
prerequisite for extension of a stay; rather, the courts have held that the extension is for the benefit of all the company’s stakeholders, not just the creditors. Unlike the \textit{BIA}, under the \textit{CCAA}, extensions on the initial stay are not limited to fixed periods or a fixed maximum, although the courts have made it clear that they expect an expeditious process. Thus for example, the \textit{Olympia and York} restructuring process, which took about 14 months and was one of the longest in Canadian history, would not have been able to develop an appropriate plan of arrangement under the more restrictive \textit{BIA}.  

Under the \textit{CCAA}, the court appoints a “monitor”, who performs a role similar to that of a trustee under proposal provisions of the \textit{BIA}. The court has discretion to direct the monitor to perform duties such as acting as liaison with the creditors, assisting in the formulation of a restructuring plan, and giving an opinion on the debtor corporation’s ability to meet the requirements of a revised business plan. Although appointment of a monitor had become accepted practice in \textit{CCAA} applications, it became mandatory with the 1997 amendments to the \textit{CCAA}. The role of the monitor is defined by statute and includes having access to the company’s records and property to the extent necessary to assess the company’s business and financial affairs. The monitor must also file a report with the court at least seven days prior to any creditors' meeting or at such times as the court directs. This report sets out the state of the company business and financial affairs and any material adverse change in projected cash flow or financial circumstances. The monitor advises creditors of the filing of the report and carries out any additional

\footnotesize{\textsuperscript{540}} Courts have also held that in the absence of evidence that the company has not acted in good faith and with due diligence in putting together a reorganizing plan, the court should accept the evidence of the company on an application for extension of a stay order. \textit{Re Downtown Lumber} (1996), 39 C.B.R. (3d) 4 (N.B.C.A.).


\footnotesize{\textsuperscript{542}} \textit{Latham}, \textit{supra}, note 468 at 5.

\footnotesize{\textsuperscript{543}} \textit{Marantz}, \textit{supra}, note 12 at 16.

\footnotesize{\textsuperscript{544}} \textit{Latham}, \textit{supra}, note 468 at 6; \textit{Ziegel}, \textit{supra}, note 42 at 761.
functions that the court may direct.\footnote{Section 11.7(3), \textit{CCAA}, supra, note 5.} Those duties may include assisting the corporation in developing a plan of arrangement or facilitating negotiations with creditors.

There had been criticisms that preserving the \textit{status quo} during the stay period in many instances required that the lenders of operating capital continue lending.\footnote{Morawetz, \textit{supra}, note 3 at 35.} However, the \textit{CCAA} was amended in 1997 to specify that the effect of a stay order does not require the further advance of money or credit.\footnote{Section 11.3, \textit{CCAA}, supra, note 5} The amendments also made clear that the stay did not have the effect of prohibiting a party from requiring immediate payment for any goods, services or use of leased or licensed property provided after the order is made.\footnote{Section 11.3, \textit{ibid.}} If there is only a single secured creditor or a few creditors, often the availability of additional operating credit is on condition that the credit ranks as a first priority in claims.\footnote{See discussion at note 603, \textit{infra} on debtor-in-possession financing.}

Typically, the directors and officers of the corporation remain responsible for the affairs of the corporation, and try to craft a plan of compromise or arrangement that is acceptable to creditors. This may involve compromising the debt, exchanging equity for debt, replacement of managers, issuance of new shares, or shifts in control of the company.\footnote{Edwards, \textit{supra}, note 46 at 592.} The monitor, as an officer of the court, ensures that they do nothing that would act to deplete the resources available to creditors.

The court’s role is to ensure that the statutory requirements have been met in terms of creditor approval, as well as ensuring that the proposal is “fair and reasonable” in all the
Courts have consistently reinforced the notion that the purpose of the *CCAA* is to provide a structured environment for the negotiation of compromises between a debtor corporation and its creditors for the benefit of both. The underlying premise is that it is better for the company, its shareholders, employees and creditors to have the company operating in such a manner that it can meet its obligations, rather than creditors being able only to receive discounted payment at liquidation or sale value, and have shareholders and employees lose their investments. The statute has been described as remedial and the courts have consistently held that it should be interpreted in a fair, large and liberal manner, with the court considering the equities in each case. It has been considered rehabilitative legislation in terms of its objectives. In this sense, it expressly differs from Jackson’s views, discussed in chapter 1, that bankruptcy law should not have a policy objective of restructuring firms. While the *CCAA* does not have an express purpose clause, the courts have been consistent in their findings regarding both the debt collection and rehabilitative nature of the statute. Since there have been two major amendments to the statute in the 1990’s and legislators have not interfered with this interpretation by enacting amendments giving the court other directions, it is safe to infer that the goals articulated by the court are public policy. The 1997 amendments also contain new provisions to deal with recognition and enforcement of international insolvency proceedings. These amendments were to both the *BIA* and the

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551 The 1997 amendments brought the approval percentages required in line with the *BIA*. Compromise may be sanctioned by the court where a majority in number representing two-thirds in value of creditors or class of creditors present and voting in person or by proxy, agree to any compromise or arrangement. If sanctioned by the Court, it is binding on all creditors or class of creditors, of any trustee for creditors, on the company, and if relevant, on a trustee in bankruptcy or liquidator or contributories of the company. Section 6, *CCAA*, supra, note 5.

552 *Elan Corporation*, supra, note 458.


555 Jackson, *supra*, note 468 at 2.
The CCAA scheme includes some aspects of my conceptual framework. It gives public policy recognition to the value of restructuring processes and the value of the court’s supervision in trying to keep the firm in operation. The regime supports creditors’ rights by requiring a minimum threshold of creditor support by number and value in a class before the court will sanction the plan. It balances creditors’ rights to enforce with an entitlement by shareholders and their agents to devise acceptable viable business plans. Thus, the stay provisions facilitate the arrangement of refinancing, the consideration of diverse creditor interests, the time to discern and negotiate with creditors with both converging and diverging interests, and thus the ability to achieve broad support for the proposed plan of arrangement or compromise. However, to date, the law has not adequately addressed the governance issues raised by my discussion in chapter 2. There is not yet broad acceptance of the participation and decision rights of non-traditional creditors and stakeholders. Practitioners have suggested that the lack of codified requirements under the CCAA gives the parties and the court the flexibility to craft constructive and timely workout plans to preserve the business. In the same vein, it also gives the court greater flexibility to recognize the interests of broader numbers of stakeholders in the negotiations for and approval of restructuring plans.

The CCAA is a vitally important part of the corporate law regime and should be recognized and retained. The new amendments requiring a minimum debt before parties

\footnote{\textit{BIA, supra}, note 5, Part XIII, International Insolvencies; CCAA, \textit{supra} note 5, s.18.6.}

\footnote{For example, the regime sets out minimum approval thresholds for creditors, failing which the proposed plan will not be sanctioned. If the CCAA application is filed for purposes of impeding enforcement of senior creditors’ rights, the application will be dismissed. If a large number of secured creditors holding claims of considerable value are opposed to development of a plan, the courts will dismiss the application after the initial or first extension of stay. F.J. Newbould and Geoffrey Morawetz, “Developments and Trends in CCAA Restructurings” (Canadian Bar Association and Insolvency Institute of Canada, 1991) at 12.}

\footnote{Dunphy, \textit{supra}, note 10 at 274.}
can make an application under the *CCAA* has not resulted in a decline in the number of applications, attesting to the significance of the statutory scheme. Although there are no statistics on the number of *CCAA* applications, they comprise a substantial portion of the time and resources of Canadian courts and involve millions in debt and thousands of employees as noted in the introduction. Similarly, while there are no statistics, some practitioners have suggested that approximately 60% to 75% of all arrangements under the *CCAA* are successful in that the corporation survives as an ongoing concern and is able to turn around its financial affairs in the several years following. These cases do consume considerable court resources, which is likely a function both of the size and complexity of corporations likely to come before the court and the amount and complexity of debt arrangements that require restructuring. However, as will be seen in chapters 4 to 7, the court-supervised process may afford a higher level of scrutiny than private workouts in terms of stakeholder interests because of the court's requirement that the plan be fair and reasonable.

The crux of the success of the *CCAA* as a restructuring tool has been the willingness of the courts to interpret the statute in a flexible and purposive manner. Mr. Justice Tysoe has observed that the successful reorganization of *Quintette Coal* in British Columbia was as a result of the flexibility of the *CCAA* and the court in allowing the parties time to negotiate and let the pieces of a successful restructuring fall into place.

There are two key substantive questions that the court decides under a *CCAA* application. First, is whether to exercise its discretion to grant the stay and the second issue is the sanctioning of a plan of compromise or arrangement. In the interim period between these orders, there are numerous decisions that the court is called upon to make. For example,

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559 Latham, *supra*, note 468.

560 Mr. Justice Tysoe, “Quintette Coal - The Story of its Reorganization” in Ziegel and Baird, *supra*, note 6, 377 at 396. In that case, negotiations took an unusual two years to complete. Yet Mr. Justice Thackray in the sanctioning decision observed that the time was not wasted in the extensive negotiations for a workout. *Re Quintette Coal Ltd.* (1991), 10 C.B.R. (3d) 197, 62 B.C.L.R. (2d) 218 (S. C.) at 240.
the definition of the classes of creditors is often crucial to a successful restructuring application and the courts have developed and refined a series of tests in order to better accomplish the objectives of the legislation. The primary objective of the legislation has been held to be the facilitating of reorganizations, a purpose that the courts have said they will consider at every stage of the process.

The CCAA scheme exists concurrently within provincial and other remedial statutes. For example, the Canada Labour Code and provincial labour relations statutes expressly preserve collective agreements when the business is sold as a business. In Ontario, for example, the Ontario Labour Relations Act specifies that the purchaser of a business is bound to the collective agreement as if it were a direct party. Sale includes lease or transfer of all or part of the business. Thus receivership does not annul the collective agreement with employees and purchasers will be bound to the collective agreement obligations. For example, the court has held that a trustee may become a successor employer for purposes of labour legislation where it continues the operation of a bankrupt’s business.

Having set out the general scheme of the CCAA, it is helpful to analyze some of the interpretive approaches of the court in CCAA proceedings, in order to assess its compatibility with my proposed framework.

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564 Ontario Labour Relations Act, supra, note 290.

565 This is in contrast to the relationship of the debtor corporation to the workers on bankruptcy. When the corporation becomes bankrupt, the collective agreement is automatically terminated.

566 Re St. Mary’s Paper Inc. (1994), 26 C.B.R. (3d) 263 (Ont. C.A.). In that case, the Court of Appeal held that the trustee had become the employer for purposes of the Pension Benefits Act and liable for special payments to existing plans.
Having set out my suggestions for the role of the judiciary in chapter 2, here I canvass how the court has played an important role in the reconciliation of interests of traditional creditors with other stakeholders and how that role can be enhanced. The court has held that because of the remedial nature of the legislation, the judiciary will exercise its jurisdiction and discretion to give effect to the public policy objectives of the statute where the express language of the provisions is incomplete. This includes endorsement of a survival program of the debtor corporation until it can develop and present a plan of arrangement. In deciding whether to exercise its discretion to approve a plan of arrangement or compromise, the court will ensure not only that the plan has received the requisite approval by creditors pursuant to the requirements of the CCAA, but also that the plan is fair and reasonable in the circumstances. The statutory scheme also contemplates that the rights and remedies of various stakeholders, including creditors, shareholders and employees, might be temporarily sacrificed in an effort to serve a “greater good” by allowing a plan of arrangement to proceed which allows the

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567 Lehnordoff, supra, note 526 at 31; Re Dylex Limited (1995), 31 C.B.R. (3d) 106 (O.C.J. (Gen. Div.) Com. List)). Farley J. at 110; Olympia and York Developments (1993), 20 C.B.R. (3d) 165 at 168; Re NsC Diesel Power Inc. (1990), 79 C.B.R. (N.S.) 1 (N.S.S.C.). Westar Mining (1992), 14 C.B.R. (3d) 88 (B.C.S.C.); Interpretation Act, R.S.C. 1985, c. 1-21, s.12. One area that deserves further study, but which is outside the scope of this thesis, are the differences generated by judicial interpretation of the CCAA in Quebec’s civil law regime and the rest of Canada, which are common law jurisdictions. Although the CCAA is a federal statute and should ostensibly be interpreted consistently, the cultural and procedural norms in Quebec differ, as do different statutory notions of “security” (Quebec secured interest) and formal registration systems. Moreover, the courts in Quebec tend to keep tighter reign on debtor corporations throughout the process. Yoine Goldstein, telephone interview (16 August 1999).

568 Re Dylex, ibid. at 10.

debtor company to continue its operations. In this respect, some scholars have suggested that the CCAA is more debtor friendly legislation. However, the feasibility of the plan is always a factor for the court's consideration in deciding whether to order a meeting of creditors to vote on a proposed plan.

One issue is how well placed the court is to assess the feasibility of a plan. As will be seen by the discussion below, the court does not try to substitute its judgment for the business judgment of the parties. However, where parties disagree as to what that business judgment is, or believe that there has been unreasonableness or unfairness in the process to workout a plan or the content of the proposed plan, the court will consider the evidence and submissions of the parties and engage in a balancing of the interests and prejudices. As will be evident in chapter 4, the commercial expertise of judges involved in restructuring cases aids the effectiveness of this decision making. Triantis explains this as a role of "gatekeepers" in the sense of screening out restructuring applications early in the process where there is no hope of creditor support, facilitating early dissemination of information regarding finances of the debtor corporation to creditors. and thus creation of a more cost effective process for workout.

i. Judicial Recognition of the Public Interest

There are three principal differences in a private workout and a CCAA court-supervised proceeding: cost, control, and public interest. A private workout is likely to be less costly

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571 Edwards, supra, note 46 at 594-5. Doherty JA in the dissenting judgment in Elan Corporation, pointed out that debtor companies should not have to "establish the likelihood of ultimate success from the outset" because applications under the CCAA are often last refuge for companies and that many proposed plans will include contingencies and variables which are uncertain at the time that the application is made, supra, note 458.

572 Triantis, supra, note 1 at 109-111.
because it does not require numerous court appearances, sanction of the court and costs of a court-appointed monitor. Second, the creditor who initiates the process with the debtor company usually has considerable control over the outcome. While the creditor would have to ensure that other creditors are satisfied with the plan, the process is considered private, and creditors do not need to take account of the public interest in their design of a workout.\(^{573}\) In contrast, from its inception, the court has recognized that there is a public interest component of CCAA reorganizations. It recognized that it was in the public interest to continue enterprises that were valuable, particularly if the corporation was supplying goods or services to large numbers of consumers or employing large numbers of workers whose employment was jeopardized.\(^{574}\) The court has held that the CCAA is broad remedial legislation designed to facilitate a restructuring of debtor corporations in such a way that is in the interests of the company, its creditors and the public.\(^{575}\) In *Quintette Coal* the Court noted that an important consideration in sanctioning the plan was the public interest in having the company survive given the significance of coal to the economy of British Columbia.\(^{576}\)

Courts have observed that the CCAA was designed to serve a “broad constituency of investors, creditors and employees” and because of this, the Court, in considering applications under the Act, will have regard not only to the individuals and organizations directly affected by the plan, but also have regard to the wider public interest.\(^{577}\)

\(^{573}\) Barry Goldberg, “The Restructuring of Beatrice Foods Inc.” in Ziegel and Baird, *supra*, note 6, 275 at 278-9. These negotiations are often accompanied by negotiation of standstill agreements between the debtor corporation and its creditors, which have many of the same features as statutory stays. They often set out a process for the development and negotiation of restructuring, recapitalization, dispositions, and restriction on assignment of claims.

\(^{574}\) Edwards, *supra*, note 46 at 593.

\(^{575}\) *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80, judgment of Mr. Justice Blair, (Ont. C.J. (Gen. Div.)).

\(^{576}\) *Re Quintette Coal Limited, supra*, note 526 at 48.

interest is generally, but not always, served by permitting a company to attempt a restructuring.\(^{578}\) Mr. Justice Doherty has held that the cessation of operations of a company, results in immediate economic and social damage to those who work for the company and their dependents, and that this kind of damage cannot be ignored by the court, especially when it occurs in small communities.\(^{579}\) Finlayson J.A., writing for the majority in the same judgment, held that the CCAA is intended to provide a structured environment for the negotiation of compromises between the debtor corporation and its creditors, and that such a resolution can have significant benefits for the company, its shareholders and employees.\(^{580}\) In Sklar-Peppler, the Court held that the plan was intended to avoid the devastating social and economic consequences of loss of business operations and allowed the corporation to carry on business in a manner that caused the least possible harm to employees and the communities in which it operated.\(^{581}\)

These notions of public interest are helpful to the framework that I proposed in chapter 2. Recognition of a public interest in facilitating the viability of firms, preserving jobs and communities confirms that my framework can be developed within the existing statutory language. In recognizing the "public interest", the courts have set the stage for participation and decision rights for broader groups of stakeholders. If according such rights to workers and other stakeholders will enhance public interest concerns, the courts will likely be willing to make such orders.

The difference between the court’s public interest definition and my own is largely a function of who is defining the public interest. Currently the parties before the courts are almost always the debtor corporation and traditional creditors. Both use the notion of "public interest" to persuade the court of their position in a particular case. Yet the

\(^{578}\) Doherty J.A., Elan Corporation, ibid.

\(^{579}\) Ibid.

\(^{580}\) Ibid. and 297. Thus the debtor corporation is entitled to a broad and liberal interpretation of the jurisdiction of the court under the CCAA.

\(^{581}\) Re Sklar-Peppler, supra, note 577.
stakeholders most affected in terms of the public interest, workers, small trade suppliers, communities, and local governments are often not represented at proceedings. Even where they are represented, it is difficult to establish what the public interest is. This is best illustrated in my discussion in chapter 7 of the Canadian Red Cross case. There, the debtor corporation argued for immediate transfer of the national blood system “in the public interest” and the tort claimants argued for delay “in the public interest” of recognizing their right to participate meaningfully in the proceeding. In Skydome Corporation, it was estimated that the enterprise generated $326 million in revenue for the economy of the greater Toronto area and $45 million in sales taxes for the Ontario Government. Thus, the court held that there is a broader public dimension which must be considered and weighed in the balance, as well as the interests of those most directly affected. Although in both of these cases it was the Court that ultimately decided what the governing “public interest” was, it arrived at its decision with the benefit of submissions from all interested parties.

It is difficult to extract a definition of “public interest” from the extensive caselaw. In interviewing members of the Canadian insolvency bar and bench for purposes of this thesis, I requested more than forty people to define “public interest”. The responses ranged from “I know it when I see it”, to “it means job preservation”, to “don’t ask me to articulate what it is”. Yet, as the discussion in this and the next four chapters illustrates, public interest under the current regime is not really a substantive objective. Rather, I have concluded that it is a “short form” for the complex balancing of diverse interests that the court engages in, in determining the various disputes that arise during a CCAA proceeding and in determining whether to sanction a plan of arrangement or compromise. In this respect, public interest includes traditional creditors, shareholders, workers and other stakeholders who have an interest in the insolvent corporation. The substantive goal of the CCAA is to afford the debtor corporation a limited period in which to devise

582 Re Skydome Corporation, supra, note 276; Endorsement (27 November 1998), (O.C.J. (Gen. Div.)), Blair J.

583 Ibid. at 4.
and win support for a viable plan to restructure its affairs. Consideration of the public interest is one of the ways in which the court assesses the viability and fairness of the proposed plan within the existing statutory scheme of priorities.

**ii. Use of the Stay Process to Recognize Diverse Interests**

With respect to the stay decision, unlike the **BIA** in which the stay provisions are automatic, under the **CCAA** the Court must determine whether it is appropriate in the circumstances to grant a stay. The court has held that its task under the **CCAA** is to facilitate compromises and arrangements between debtor corporations and their creditors, and to ensure that the facilitative process is effective. Thus it is essential that the debtor corporation be afforded a respite from litigation during the period that it is attempting to carry on as a going concern and to negotiate a plan acceptable to creditors.\(^5\) The courts have therefore more recently interpreted the stay provisions liberally in order to facilitate the negotiation process and in order to keep businesses operating where that is viable.\(^5\) Where the court has granted an initial stay in face of opposition from some of the key creditors, the stay period imposed is often a very short timeframe, with a fixed date to come back before the court to allow the debtor corporation to establish that it has a reasonable chance of successfully negotiating with creditors.\(^5\)

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\(^5\) _Re Lehndorff_, supra, note 526; _Elan Corporation_, supra, note 458. This has not always been the case. In _Elan Corporation_ the majority held that where the evidence before the court is not persuasive with respect to a reasonable chance of success, the court should exercise its discretion to refuse to grant a stay. As a result, in the early 1990's there were a number of cases in which the opposition of major creditors at the initial stay part of the proceedings resulted in the court refusing to grant the stay. See for example _First Treasury Financial Inc. v. Cango Petroleums Inc._ (1991), 3 C.B.R. (3d) 232 (Ont. C. J. (Gen. Div.)); _Re Ursel Investments Ltd._ (1991), 2 C.B.R. (3d) 260 (Sask. Q.B.).

Generally, given the objectives of the legislation, the court will grant a stay, unless it finds that the *CCAA* application is merely an effort by the debtor company to avoid its obligations to creditors or that creditors have lost all confidence in management of the corporation. The court has fairly consistently held that the debtor company does not have to demonstrate at the stage of applying for an initial stay order that it has a plan of arrangement that is feasible, because the precise reason for the stay is to afford the company a limited period in which to attempt to develop a plan. The courts have said, however, that debtor corporations are well advised to have consulted with major creditors in advance of the request, in order to ascertain whether they are willing to co-operate in the negotiation of a work out. The courts have held that where it is clear that there is no viable plan that will be accepted by the requisite number of creditors and value of claims, the stay should not be granted. However, where a number of secured creditors are initially opposed to the stay, the matter does not end there, and “all affected constituencies must be considered including secured, preferred and unsecured creditors, preferred creditors, employees, landlords, shareholders and the public generally”. These cases represent a shift towards consideration of all affected interests.

As noted above, the court applies tests of good faith, due diligence, and prejudice to creditors in determining whether to extend the stay period. The British Columbia Court of Appeal in *Chef Ready Foods* held that the objective of the stay provisions under the *CCAA* is to provide a protective device, not only for the benefit of the debtor

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587 Ibid.
588 Ibid.
589 *Bargain Harolds Discount Ltd. v. Paribas Bank of Canada* (1992), 10 C.B.R. (3d) 23 (O.C.J. (Gen. Div.)) at 30, citing Icor Oil and Gas Co. v. Canadian Imperial Bank of Commerce, supra, note 570 at 164. The court has held that the onus should be on the major opposing creditor to demonstrate why the order ought not to be made. However, the difficulty with this may be that creditors do not have sufficient information at the initial stay proceeding to discharge this onus.

590 *Bargain Harolds*, *ibid.* at paragraph 35.

591 Section 11(4) of the *CCAA* specifies that there is an additional requirement of good faith and due diligence in whether the court should exercise its discretion to grant the additional stay. *Royal Oak Mines Inc.* (10 March 1999) O.J. No. 709 (O.S.C.J. (Commercial List)), Blair J.
corporation, but also for the broad constituency of creditors, employees, investors and shareholders.\textsuperscript{592} It held that to the extent that there was an operational conflict between the \textit{CCAA} and debt enforcement legislation such as the \textit{Bank Act}, the remedial nature of the \textit{CCAA} requires that it take priority.

In terms of the tests applied by the court in granting the stay, the balance of convenience must weigh significantly in favour of granting the stay, given that access to the courts by creditors and other claimants should not be interfered with lightly.\textsuperscript{593} The court must be satisfied that continuance of a proceeding would serve as an injustice to the debtor corporation seeking the stay, in the sense of being oppressive or an abuse of the court's power.\textsuperscript{594} On the other hand, the stay must not cause an injustice to the plaintiff seeking to enforce rights.

In a recent judgment giving expanded reasons on the granting of an initial order in \textit{Royal Oak Mines}, the Court expressed concern about the growing complexity of Initial Orders being sought under the stay provisions of the \textit{CCAA}.\textsuperscript{595} The Court acknowledged the helpfulness and efficiency of the practice of bringing pre-packaged draft orders in which the debtor corporation has first sought the input and approval of senior creditors.\textsuperscript{596} However, the Court expressed concern about the growing tendency to attempt to incorporate provisions to meet all eventualities that may arise during the \textit{CCAA} proceedings.\textsuperscript{597} Given that initial applications are made on short or no notice, the extensive relief being sought at the initial order stage in this and other recent applications was beyond what could appropriately be accommodated within the bounds of procedural

\textsuperscript{592} \textit{Hongkong Bank of Canada} v. \textit{Chef Ready Foods Ltd.}, supra, note 531.

\textsuperscript{593} \textit{Campeau}, supra, 561.

\textsuperscript{594} \textit{Ibid.}

\textsuperscript{595} \textit{Re Royal Oak Mines}, supra, note 591, at paragraph 9.

\textsuperscript{596} \textit{Ibid.} at paragraph 8.

\textsuperscript{597} \textit{Ibid.} at paragraph 9.
fairness. The Court held that it must balance the need to move quickly with the requirement that parties be given an opportunity to digest the information, consider their position, and advance their interests. The Court emphasized that the initial stay period is precisely that, a very limited period in which the debtor corporation is given protection in order to give it time to negotiate and garner support for its application and a process to negotiate a plan. The Court acknowledged the need for a certain degree of complexity in initial orders, but urged plainer more readily understandable language in initial orders, suggesting that “they should not read like trust indentures.”

These judicial pronouncements suggest that the stay mechanism, particularly approval to extend the stay, could be a useful tool for my conceptual approach to restructuring. The purpose of the stay is to give the debtor corporation a limited period in which to determine whether a viable plan can be developed and to allow dissemination of information to creditors to allow them to assess their options. Disclosure at the outset of the process reduces costs for workers, small trade creditors and other stakeholders seeking to participate. Given that the courts have already recognized that the stay as a protective device can benefit a broad set of constituencies, it clearly could assist with the participation and decision rights that I advocate be given to non-traditional stakeholders. For example, the debtor corporation would be obliged to seek the co-operation of these stakeholders in fulfilling its good faith and due diligence obligations in trying to develop a plan, particularly if an extension of the stay was needed. The court’s consideration of the motion to extend the stay would take account of the interests of these stakeholders, including an assessment of the debtor corporation’s good faith negotiations with them. Moreover, the recent direction to simplify initial orders, and to give additional notice and

598 Ibid. at paragraph 17.
599 Ibid. at paragraph 7.
600 Ibid. at paragraph 15.
601 The Court stressed that this should be true of all orders but particularly initial orders. Ibid. at paragraph 20. The direction given by the Court in this judgment was also cited with approval by Mr. Justice Farley of the Superior Court of Justice, Commercial List at a recent forum on DIP Financing. Remarks (9 June 1999) (CBAO Insolvency Law Section Meeting, Toronto, 1999).
time to allow parties to consider their interests, should act to enhance access to the process by those stakeholders who traditionally have not been involved.

iii. Interim and Ongoing Funding: the Public Policy Function of Super-Priority Financing

The courts have interpreted their equitable jurisdiction as including the ability to order Debtor-in-Possession (DIP) financing to allow corporations to continue operating during the stay period under the CCAA. This can sometimes represent a significant compromise of creditors’ traditional rights. Prior to the development of DIP financing, debtor corporations required the financial support of operating lenders to carry on business during the restructuring process. This in turn increased accountability because without the support of the operating lender, the debtor corporation did not have the interim financing to cover the period in which it was attempting to develop a plan. Morawetz has observed that early Canadian cases of DIP financing did not really analyze the nature of the financing charge because the financing was of a type that did not jeopardize the pre-insolvency ranking of secured credit or because the financing was obtained with the consent of other secured creditors. Thus, notwithstanding the

602 The courts also grant DIP financing under BIA proposal provisions. A few CCAA cases also refer to “GAR” funding, “general, administrative and restructuring” funding. These terms are in part interchangeable, although one might argue that DIP financing is a more inclusive term because it relates to financing beyond that required to actually restructure.


605 Ibid. at 2.
absence of statutory provision for such financing, issues of jurisdiction did not arise. It was not until the courts began to grant such financing where there was not unanimous consent of secured creditors or where there was some interference in priorities, that the Court was faced with questions of the scope and limits of its inherent jurisdiction to grant such financing. Then issues of jurisdiction, including the tension between federal insolvency legislation and provincial property legislation became highlighted.  

The courts now regularly grant financing to the debtor corporation to allow it to carry on business pending the development of a proposal or plan. The courts have found authority for granting super-priority of this funding in their inherent jurisdiction, and in their jurisdiction under the CCAA and other statutes, including granting priority to shareholders who advance such financing.  

The granting of DIP financing has included cases where the security was granted on unencumbered assets of the debtor corporation, where the existing secured creditor was not adversely affected by the financing order, where the money was advanced for the benefit of all creditors, and where the reduction in value of existing creditors’ security was not significant in terms of the overall value involved and in terms of the overall economic and financial effects of declining such a request.  

The policy reasons specified by the courts are that in restructuring proceedings the court will engage in a balancing of prejudices between the parties, and that secured creditors

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606 Morawetz points out that for existing secured creditors that believed they had a first or second registered charge over certain property as set out in provincial legislation, the notion that priority could be altered by the granting of DIP financing was problematic. Ibid. at 1.

607 Skydome Corporation, supra, note 276.


609 Re Dylex Limited, supra, note 603.


611 Skydome Corporation, supra, note 276.
may be required to make some sacrifice.612 This is because there are reasonably anticipated benefits for all stakeholders that are to be derived from some sacrifice.613 In *Re Dylex Limited*, the Court found that in the absence of new priority financing even where there was an opposing secured creditor, that the company would not have been able to obtain the inventory for stores nor provide assurances to suppliers to guarantee future production.614 In granting the order for DIP financing, the Court considered two key factors, the large number of direct and indirect employees and the fact that opposing creditors would not be adversely affected.615 Mr. Justice Houlden concluded that granting such funding was the only way in which the company could continue in operation to the benefit of 12,000 employees and large numbers of people indirectly affected such as suppliers and their employees.616 The courts have held that while creditors are not compelled to give any additional credit, the creditors’ security may be weakened by the court’s approval of DIP financing.617

More recently, Mr. Justice Blair of the Ontario Superior Court of Justice, in the granting of DIP financing in the *Royal Oak Mines Inc.* case held that the financing should be enough to “keep the lights on” and enable it to meet appropriate preventive maintenance measures.618 In *Royal Oak*, the debtor corporation was seeking super-priority financing over all lenders, including some lien claimants. The lien claimants, who the Court noted that everyone acknowledged ranked first in priority, were not given notice of the application.619 The Court was concerned about the quantity of proposed DIP financing


614 *Re Dylex Limited*, supra, note 603.


618 *Re Royal Oak Mines, supra*, note 613 at paragraph 24.

on such broad terms and without the benefit of interested parties having the opportunity to properly review the information and to consider their positions.\textsuperscript{620} The Court held that financing requests in initial orders should be confined to what is reasonably necessary for the continued operation of the debtor corporation during a brief but realistic period on an urgent basis.\textsuperscript{621} This is because the granting of such priority often places encumbrances ahead of pre-existing claims.\textsuperscript{622} The Court thus limited the amount of DIP financing that it would sanction in the initial order.

Subsequent to that decision, Mr. Justice Farley, in the same CCAA application, held that while the courts had considerable power under both the CCAA and their inherent jurisdiction to grant super-priority financing, that jurisdiction was not limitless.\textsuperscript{623} Thus while DIP financing may be granted because it is reasonably anticipated that there are benefits to be derived from any compromise of creditors’ claims, there may be statutory provisions that limit the inherent jurisdiction of the court to grant such priority.\textsuperscript{624} Here, the Court held that the Builders Lien Act operated in such a way as to eliminate the Court’s jurisdiction to grant a super-priority of DIP financing over the lien claimants.\textsuperscript{625}

\textsuperscript{620} Ibid. at paragraphs 12, 21.

\textsuperscript{621} Ibid. at paragraph 21.

\textsuperscript{622} The Court held that “such changes should not be imported lightly, if at all, into the creditor mix; and affected parties are entitled to a reasonable opportunity to think about their potential impact, and to consider such things as whether or not the CCAA approach to the insolvency is the appropriate one in the circumstances – as opposed for instance, to a receivership or bankruptcy, and whether or not, or to what extent, they are prepared to have their positions affected by DIP or super priority financing”. \textit{Ibid.} at paragraph 24.

\textsuperscript{623} \textit{Ibid.}, citing \textit{Baxter Student Housing Ltd. v. College Housing Co-operative Limited} (1975), 57 D.L.R. (3d) 1 (S.C.C.) and \textit{Canada (Minister of Indian Affairs and Northern Developments v. Curragh Inc.} (1994), 27 C.B.R. (3d) 148 (O.C.J. (Gen. Div.)) at 159.

\textsuperscript{624} \textit{Ibid.} at paragraphs 22, 23.

\textsuperscript{625} \textit{Ibid.} at paragraph 23. Mr. Justice Farley held that even if he did have jurisdiction to grant a super-priority over the liens, he would decline to exercise his discretion in this respect on the particular facts of the case. \textit{Builders Lien Act}, R.S.B.C. 1996, c. 41 at section 11.
The issue of DIP Financing is currently a hotly debated one, particularly in light of the increase in CCAA applications, accompanying applications for DIP financing, and the appearance for the first time of DIP financing specialty lenders. 626 Geoffrey Morawetz has pointed out that there are essentially three types of DIP financing and they raise different considerations. First, is where the court grants such financing but there are no secured creditors and thus those interests are not compromised. This is rarely the case with the modern corporation. 627 Second, is the situation where the value of the assets of the debtor corporation exceed secured liability, and thus the granting of DIP financing does not prejudice secured creditors. Morawetz questions, however, why such financing therefore does not simply fall in priority after the claims of those pre-existing secured creditors. 628 The third situation is where the value of the assets is less than the amount of pre-existing secured credit and thus senior creditors are compromised when the court order sanctions DIP financing. Morawetz points out that it is this situation that is most troubling to secured creditors and for which there should perhaps be guidelines directing the court’s consideration. 629 He suggests that restructuring would be facilitated if there was a statutory amendment permitting DIP financing under certain conditions, including respecting the rights of both debtors and creditors, adequate valuing of encumbered and unencumbered assets, and requiring that approval of such financing is contingent on providing adequate notice to affected parties. 630 In turn, this would give direction and

626 Morawetz, supra, note 604 at 1.

627 Geoffrey Morawetz, (9 June 1999) (Remarks to CBAO forum on DIP financing). See for example, Sammi Atlas, supra, note 331, in which 1400 unsecured creditors held $400 million in debt. Morawetz, interview (1 April 1999).

628 ibid.

629 ibid. Similarly Jones and Dixon have observed that while there is support in the business community for the concept of priority for extending credit during the restructuring process, statutory direction would be helpful to guide parties. R. B. Jones and R.C. Dixon, "Oakwood Petroleums Ltd." in Ziegel and Baird, supra, note 6 at 353.

630 Morawetz suggests that statutory provisions could mirror somewhat the provisions of U.S. law in this respect. In the U.S. super-priority financing is granted only where the debtor is able to establish the existing secured creditors are adequately protected, that credit could not otherwise be obtained, and that adequate notice is given to parties and a hearing held before the court grants such requests. Morawetz, supra, note 604 at 6.
certainty to parties in their consideration of whether to endorse requests for DIP financing.

Thus, depending on which category the debtor corporation falls within, the granting of DIP financing may be more or less controversial for secured creditors. The granting of such funding may allow a corporation to keep operating, in order to retain value while trying to negotiate a workout with creditors. For stakeholders such as workers or local governments, it may also result in preservation of their equitable investments, at least for the period that a possible restructuring plan is being formulated. According super-priority financing has also been aimed at protecting or ensuring compliance with environmental obligations, an aim clearly in the interests of the public. Moreover, approval of DIP financing to keep “the lights on” may also assist local suppliers in terms of their investments in the firm. Since they can demand cash in exchange for any new supplies, the DIP financing might ultimately be aimed at preserving their interests. Thus, the exercise of the court’s discretion to grant such priority has been helpful to non-traditional creditors and stakeholders, as well as to secured creditors and debtor corporations. Conceivably, the court could use this discretionary power as another tool in according stakeholders a role on the process. For example, where a corporation has failed to disclose its finances to trade creditors, workers or other claimants, or where it refuses to recognize their participation rights when considering financing decisions, the court could exercise its discretion not to grant further financing on a super-priority basis.

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631 For example, in Royal Oak Mines, a portion of the DIP financing was aimed at environmental protection. In other circumstances, the courts have held that a receiver can organize DIP financing for the preservation or improvement of property. In King v. Rolex, the receiver expended money on clean up of a garbage dump. The Court held that the interests of the residents outweighed the detriment to the mortgagee. It was contrary to the public interest to have a community unable to deal with the dump because the creditor with the greatest interest refused to act; at 462-3, cited in McLaren, supra, note 37 at 4.4623.
iv. Definition of Classes as a Tool to Facilitate Restructuring

The approval of a proposed plan of arrangement or compromise is dependent on the creditors voting in favour of the proposed plan by class in terms of a majority of creditors in a class and two thirds of the value of the claims. Thus, the determination of "class" becomes a key issue in CCAA proceedings. Creditors who are lumped in classes in which the other creditors are very supportive of the debtor corporation, have much less chance of vetoing a proposed plan. As a consequence, both creditors and the debtor corporation typically try to frame the classes in such a way as to maximize their voice and control rights in the restructuring process.

The court's role includes approval of the classification of creditors for the purpose of considering the plan and there has been considerable litigation on the issue of what comprises a "class of creditors" for purposes of the CCAA.\(^\text{632}\) The court applies a "commonality of interest" test, having regard to the objectives of the CCAA. If the court finds that a different state of facts exist among different creditors which may differently affect their minds and their judgment, they must be divided into different classes.\(^\text{633}\) A class should be made up of creditors whose rights are "not so dissimilar as to make it impossible for them to consult together with a view to their common interest".\(^\text{634}\) The courts have sometimes also adopted an anti-fragmentation approach, grouping creditors


\(^{633}\) Elan, supra, note 458, at 1891, citing Sovereign Life Assurance, ibid. at 580. Re Fairview Industries Limited (No. 3) (1991), 11 C.B.R. (3d) 71 (N.S.T.D.) in which the Court held that creditors may have the same legal interests even where they have different commercial interests and every class must be made aware of any difference in treatment of claims. Generally, commonality of interest might include "legal interest" or might reflect similarities in non-legal interests. However, even while classes are determined by legal entitlement, there is an argument for separating workers from other unsecured creditors because of their equitable interest.

\(^{634}\) Re Sklar-Peppler Furniture Corporation, supra, note 577 at 627; Re NsC Diesel Power Inc. (1990), 79 C.B.R. (N.S.) 1 at 8.
with a sufficient community of interest and rights so as to not unnecessarily fragment the voting process and thus allow one creditor to unduly influence negotiations or to defeat the proposed plan.\textsuperscript{635} Thus, debtor corporations can class creditors with a sufficient community of interest or commonality of remedies in the same class, and if the majority and two thirds in value of the creditors are in favour of the proposed plan, the plan cannot be vetoed by a dissenting creditor.

It is in the interests of a secured creditor to be placed in a class that it controls or has greater than a third of the value so that it can exercise an effective veto.\textsuperscript{636} In this way, the debtor corporation is required to seriously seek its consent to the proposed plan. Secured creditors often seek to be placed in separate classes based on the type of security or its legal or commercial attributes. However the courts have been careful to approve classes in such a manner to ensure that similar interests and priorities are grouped, thus minimizing the potential for any one creditor to unfairly manipulate the process.

The debtor corporation's employees are often included in a single class with other unsecured creditors in the plan. In \textit{Re Woodward's Ltd.} the Court refused to classify terminated employees as a separate class and included them with other unsecured creditors who were more supportive of the plan.\textsuperscript{637} The definition of class can thus be used as a form of "cram down" of the plan on dissenting creditors within a class.

Although Canada does not have formal cram-down provisions such as those in the \textit{U.S. Bankruptcy Code}, the fact that classes can be creatively constructed and that their designation requires court approval, results in a situation where the courts can and have

\textsuperscript{635} \textit{Re Woodward's Ltd.} (1993), 84 B.C.L.R. (2d) 206 (B.C.S.C.); \textit{Armbro Enterprises Inc.} (1993), 22 C.B.R. (3d) 80 (O.C.J.(Gen. Div.)), at paragraph 8, or to give such creditors undue advantage in the negotiations for a plan. The Court held that equality of treatment, as opposed to equitable treatment, is neither a necessary nor desirable goal; \textit{Re Keddy Motor Inns Ltd.} (1992), 13 C.B.R. (3d) 245 (No. 4), 299 A.P.R. 246 (C.A.).

\textsuperscript{636} Newbould and Morawetz, \textit{supra}, note 557 at 13.

\textsuperscript{637} \textit{Re Woodward's Ltd.} (1993), 20 C.B.R. (3d) 74 (B.C.S.C.). In commenting on the case, counsel for one the parties noted that a segregation of workers into a separate class would have created an obstacle to achieving the plan because workers were less supportive than trade creditors. Michael Fitch, "Store Wars: The Saga of Woodward's Reorganization" in Ziegel and Baird, \textit{supra}, note 6 at 535. See also \textit{Parisian Cleaners and Laundry Ltd. v. Blindin} (1938), 20 C.B.R. 452 (Que. C.A.).
used the definition of classes of creditors to facilitate acceptance of a plan. In *Norcen*, the Court held that the legislation gives the court authority to alter the legal rights of parties other than debtors without their consent and that the purpose of the scheme is to facilitate reorganizations.

While there is some controversy about the court’s role in this type of “cram down” through approval of classes, it is clear that the courts will generally accept definitions of class which meet the objectives of the *Act*, i.e. to create a mechanism to facilitate restructuring, while respecting, as much as possible, the rights of creditors. The same rationale might be used to persuade the court to define classes in a manner that enhances the participation and decision rights of broader numbers of stakeholders, as discussed in chapter 2. The court would have to be persuaded that the addition of classes, or the classifying of workers separately from other unsecured creditors is with a view to advancing the objectives of the legislation. Given both the anti-fragmentation and commonality of interest approach of the courts, workers or other investors would have to persuade the court that the nature of their interest or investment was such that their "minds and judgment are differently affected" and it is impossible for them to "consult together (with other unsecured creditors) with a view to their common interest". Since the rationale for enhanced participation and decision rights for workers, local governments and other stakeholders is that they have unique human capital investments or have an interest in the successful restructuring of the corporation, such arguments might be persuasive to the court.

The court will also consider the timing of when objections to definition of class are raised. In *Armbro Enterprises*, when a landlord sought separate class status, the Court

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638 In the United States cram-down cannot be used if a junior class gets better treatment, see discussion in chapter 9, infra.

639 *Norcen, supra*, note 562 at 308. See also *Icor Oil and Gas Co. v. C.I.B.C. (No. 1)* (1989), 102 A.R., 161 (Alberta Q.B.) at 165.

640 *Elan Corporation, supra*, note 458 at 1891; *Sklar-Peppler, supra*, note 557 at 8.
found that there was sufficient community of interest between the landlord and other unsecured creditors and that a separate class would cause unnecessary fragmentation.\textsuperscript{641} The Court also concluded that the landlord had left it too late in terms of raising the issue of class, that it had adequate notice, had failed to raise the matter early in the process either at the creditors’ meeting or by bringing the matter back to the court, and that to wait until the sanctioning hearing was too late unless there was some sort of substantial injustice. The Court found that in the circumstances no substantial injustice existed.\textsuperscript{642} Thus, where workers or other non-traditional creditors are seeking decision rights, they will have to establish those interests early in the process.

It is not just the definition of class, but how claims are satisfied within a class that may encourage recognition of human capital investments. In the \textit{CCAA} application of \textit{Mac’s Milk}, there were 596 directly employed workers, 748 independent dealers, and 284 franchise stores employing 16,000 workers.\textsuperscript{643} Although workers were in the same class as unsecured creditors, their claims were treated differently in order to give them a choice about the amount of risk they were willing to bear in the restructured corporation. The evaluation of workers’ claims was based on a formula that took into account job levels and experience.\textsuperscript{644} Workers were then given an option of receiving shares in the amount of their claims and acquiring the attendant risk, or of taking 50\% of the value of their claims in cash payments over eight quarterly payments.\textsuperscript{645}

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\textsuperscript{641} \textit{Re Armbro Enterprises Inc.} (1993), 22 C.B.R. (3d) 80 (O.C.J. (Gen. Div.)).
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\textsuperscript{642} \textit{Ibid.} at 84.
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\textsuperscript{643} Patrick O’Kelly, “A Marriage of Convenience, the Mac’s Milk Plan” in Ziegel and Baird, \textit{supra}, note 6 at 465.
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\textsuperscript{644} \textit{Ibid.} at 488.
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v.  **The Sanctioning of the Plan of Arrangement or Compromise**

To arrive at consensus has not been easy and has required all parties to make accommodations and sacrifices. I want to congratulate all those who have been involved in the negotiations for what they have accomplished. As a result of your efforts, Dylex has been kept in business and some 13,300 jobs have been preserved. I have reviewed the material and I am satisfied that all the statutory requirements of the *CCAA* have been complied with.

Mr. Justice Houlden, 1995 \(^{646}\)

The scheme of the legislation contemplates that the court will sanction a plan of compromise or arrangement. In considering whether to sanction a plan under the *CCAA*, courts will examine three criteria: whether there been strict compliance with all the statutory requirements; whether all materials filed and procedures carried out were authorized by the *CCAA*; and finally, whether the plan is fair and reasonable. \(^{647}\)

In terms of the statutory requirements, the Applicant debtor corporation must prove that it is insolvent within the meaning of the legislation. \(^{648}\) The court will also assess the appropriateness of the classes of creditors for purposes of voting and approval, and will satisfy itself that the meetings were held and votes conducted in compliance with the

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\(^{648}\) *Olympia & York*, *ibid.* at 6.
statutory scheme. Negotiation of the plan should be undertaken in a structured environment, supervised by the court, to ensure that it is balanced and reasonable.

The court has held that its assessment of whether a plan is fair and reasonable involves two key concepts that underscore the philosophy and workings of the *CCAA*. In *Olympia & York Developments*, the Court held that "‘fairness’ is the quintessential expression of the court’s equitable jurisdiction- although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation makes its exercise an exercise in equity- and ‘reasonableness’ is what lends objectivity to the process". Fairness is assessed by whether the plan is feasible, whether it fairly balances the interests of all the creditors, the company and its shareholders. The court has held that it must weigh the equities or balance the relative degrees of any prejudice that might flow from granting or refusing the relief sought under the *CCAA*.

The courts have held that one measure of whether a plan is fair and reasonable is the parties’ approval of the plan and the degree to which approval is given. The *CCAA* specifies that where a majority in number representing 2/3 of the dollar value of the claims of creditors or class of creditors agree to any compromise or arrangement, the

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649 *Armbro Enterprises Inc.*, supra, note 635. For example, the Court held that there was a sufficient community of interest and rights among a landlord and other unsecured creditors to warrant them being placed in the same class, and that one class of unsecured creditors avoided unnecessary fragmentation, at 83.

650 *Olympia & York*, supra, note 442 at 9.


654 *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (B.C.C.A.) at 116; *Re Campeau Corp.*, *ibid*.

655 *Olympia & York*, supra, note 442 at 1.
court may sanction the arrangement. If approved, the plan of compromise or arrangement is binding on all the creditors or class of creditors and any trustee for a class of creditors, whether secured or unsecured. The court has held that parties generally know what is in their best interests, and in engaging in the fairness inquiry, the court will be reluctant to refuse to sanction a plan where creditors have strongly supported the plan. However, the court has also held that the language of the CCAA is discretionary in that there is no requirement that all proposed plans of arrangement be put to a meeting of creditors. Rather, the court in exercising its discretion to order a vote must consider whether the proposed plan of arrangement has a reasonable chance of success.

In the absence of any express language requiring that every class must approve the plan, the court has held that approval of a plan of arrangement by all classes of creditors is not always necessary, where the plan is found to be fair and reasonable. For example, in Olympia & York Developments, a proposed plan of arrangement involved Olympia & York Developments and 29 affiliated corporations. Olympia & York was at the time one of the largest real estate empires in the world, with holdings in Canada, the United States, England and Europe. Essentially, the reorganization plan proposed a five-year strategy with a series of complex restructuring transactions to reorganize the business and affairs of the Applicant corporations. One practitioner characterized it as a CCAA

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656 CCAA, supra, note 5 at section 6. Elan Corporation, supra, note 458.

657 CCAA, ibid. at section 6(a) and (b).

658 An exception might be where the court is persuaded that the plan is unethical. École international de Haut Esthetique (1989), 78 C.B.R. (N.S.) 36 (C.S. Qué.).


660 Olympia & York Developments, supra, note 442 at 1; see also Multidev Immobilia Inc. v. Société Anonyme Just Invest (1988), 70 C.B.R. (N.S.) 91 (Que. S.C.) in which the Court held that it would be contrary to the objective of the statutory scheme to permit a secured creditor who had been paid in full to in effect veto an arrangement approved by other creditors.

661 Olympia & York Developments, ibid. at 3.

662 The Court found that a key part of the plan was that the secured creditors were ceded the right, if they chose, to exercise their realization remedies at any time, on specific notice and timing. This, they were able to drop out of the plan if they chose, ibid. at 3.
controlled liquidation. Secured creditors were to receive interest payments and were able to opt out of the plan (the "drop out" clause) and realize on their security at any time (with notice). Payment of principal was postponed for a five-year period. The claims of unsecured creditors were postponed for five years, with interest to accrue at the rate specified in the particular contract. Moreover, unsecured creditors were given some ongoing rights of disclosure, some control over transfer of real estate, and at the end of the five years, the option of converting their debt to stock. Only 27 of 35 classes of creditors voted in favour of the plan of arrangement. The plan provided that the claims of creditors who rejected the plan were "unaffected claims" in the sense that they were not bound by the provisions of the plan. Interestingly, none of the classes of creditors who did not support the plan at the creditors' meeting opposed the plan at the sanctioning hearing. Just as interesting is the fact that the creditors who voted in favour were willing to adopt the plan knowing that others were not bound by it. The Court held that the CCAA is remedial and that it must be given a wide and liberal construction so as to effectively serve its purpose. It held that there was no prejudice to the classes of creditors who did not approve the plan because none of their rights were taken away and nothing had been imposed on them that they had not accepted. The CCAA allows a debtor corporation to apply for approval of a plan only to the extent that the classes affected by the plan have agreed to it. The Court held that it would not

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663 Geoffrey Morawetz made this observation in reviewing a draft of this thesis (22 July 1999).

664 Olympia & York Developments, supra, note 442, at 11.

665 Ibid. at 11-12. Given that there was unlikely to be any assets to satisfy the claims of unsecured creditors if the corporations had been liquidated, this plan provided a viable alternative to complete loss of claims by unsecured creditors.

666 Ibid. at 2.

667 Ibid. at 14. The Court still decided the issue of whether unanimity was required under its obligations to ensure that the statutory requirements had been met.

668 The eight classes that did not vote in favour of the plan were each secured creditors holding security against a single asset or project (or in one case against a single group of shares). Ibid. at paragraph 56.

669 Ibid. at paragraph 61.

670 Ibid. at paragraph 11. Thus, members of those classes of creditors who voted against the plan were deemed not bound.
sanction a plan if the effect of doing so would be to bind a class of creditors that had rejected it.\textsuperscript{671} Thus, sanctioning is not completely dependent on unanimity of approval among classes. In the Court's determination of whether to sanction the plan, the question is whether there is any unfairness to creditors who have not approved the plan.

Once a plan of compromise or arrangement is sanctioned by the court, it becomes binding on the debtor company and on its creditors. Thus, fairness and reasonableness are assessed in the context of a proposed plan's impact on creditors, having regard to the purpose of the statutory scheme.\textsuperscript{672} Courts will look at all categories of interest holders and assess whether their compromises are fair and reasonable in the circumstances.\textsuperscript{673} The courts have generally held that the onus is on the party seeking to have the court refuse to sanction a plan to demonstrate that the substance of the plan is not fair and reasonable.\textsuperscript{674} Where a plan has been accepted by creditors, the party seeking to have the court refuse the proposed plan must establish that it is unethical or that there are "serious grounds" for refusing to sanction it.\textsuperscript{675} Only in exceptional circumstances will the plan of arrangement be amended once it has received court approval.\textsuperscript{676}

\textsuperscript{671} Ibid. at paragraph 16.

\textsuperscript{672} Ibid. at paragraph 9.


\textsuperscript{674} Bargain Harold's Discount Ltd. v. Paribas Bank of Canada (1992), 10 C.B.R. (3d) 23 (O.C.J. (Gen. Div.)). Re Keddy Motors Inns Ltd., supra, note 635, in which the Nova Scotia Court of Appeal held that the Court's role is to ensure that creditors who are unwillingly bound to a plan of arrangement under the Act are not forced to accept terms that are unconscionable and to ensure that they are not made victims of the majority.


\textsuperscript{676} For example, in Algoma Steel, the Court allowed a creditor with a potential claim against the corporation's insurer to bring proceedings notwithstanding the fact that the plan specified that all creditors' claims were discharged. A U.S. company with a judgment against it under product liability legislation alleged that the steel used to make the product was defective. The Court held however that the claim was not enforceable against the assets of the corporation other than an amount limited to insurance proceeds. Algoma Steel Corporation v. Royal Bank (1992), 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 55 O.A.C. 303 (Ont. C.A.), leave to appeal to S.C.C. refused (29 October 1992).
The court has also used the business judgment rule to defer to plans of arrangement which are particularly complex. For example, the plan of arrangement in *Olympia & York Developments* was characterized by the Court as one of the most complex and largest in Canadian corporate history. In that case, the Court held that it was not its function to examine the details of the business plan in all its minutiae, nor would it second guess or substitute its own judgment for the business judgments of the business people involved in negotiating the plan in their own best interests. Rather, the court’s role is to satisfy itself that the plan is fair and reasonable in the sense that it is feasible and that it fairly balances the interests of the company, its creditors and its shareholders. Part of that assessment is to examine the sophistication of the creditors and whether they received experienced legal advice. The Court will also look at the quantum of support for the plan, declining to interfere with plans that have the overwhelming support of creditors. The underlying premise is that where creditors have concluded that the proposed plan is a viable business plan, the court should not second guess that judgment. Tay has distilled from the Court’s reasoning in *Olympia & York* two operating factors. First, the court will assess whether the stakeholders will receive at least as much as they would in a liquidation scenario, and second, that the interests of stakeholders who would otherwise receive value in liquidation are paramount. Thus, while the court will consider the interests of all stakeholders, creditors are still the priority and the plan must meet the threshold of achieving liquidation value.

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677 *Olympia & York, supra*, note 442 at 10.

678 Ibid. at 10. See also *Northland Properties Ltd. supra*, note 534 at 205 (C.A. decision); *Re Keddy Motor Inns Ltd. supra*, note 635.


680 Ibid. at 11.

681 Ibid. at 11.

682 Tay, *supra*, note 461 at 197.

683 In this respect, Canadian law has come to mirror American caselaw on the liquidation value approach, although in the U.S. this is strictly codified and will act to defeat a plan if not met. See discussion of Chapter 11 of the U.S. *Bankruptcy Code* in Chapter 9.
The court's approach to the assessment of the fairness and reasonableness of a proposed plan is clearly creditor based. This makes sense given the statutory language. However, the court has been equally clear that the assessment of fairness involves a balancing of the equities in any given case. Thus, the fairness hearing is a mechanism that could advance my ideas. Where stakeholders are creditors within the meaning of the CCAA, the court will already balance the relative equities and prejudice. If courts could be persuaded to recognize the broader investments at risk for stakeholders, this could form part of the balancing at the hearing to approve the plan. In turn, this would enhance participation and decision rights because debtor corporations and traditional creditors would understand that the court will ultimately take account of these interests.

However, parties are entitled to some certainty, in terms of how courts will view the value or quantum of such claims, in order that they can negotiate for a viable restructuring plan on an informed basis. This is key to my ideas. Although I do not set out one optimal means of assigning value to these claims, I have suggested in chapter 2 that determining value can be done by such methods as actuarial calculation such as assigning a value to amounts invested by local government in infrastructure to support the corporation or, by according value to workers' investments based on years of service as is currently done in seniority provisions of collective agreements. Although judicial decision-making would clarify which types of calculations appropriately value claims, the mechanisms are already in place for these types of calculations. A clear understanding of the quantum of claim will facilitate workouts. It will also help lenders ex ante assess the ex post risks involved in granting credit so that they can determine whether or not to provide the financing which enables the solvent enterprise to start up, continue to operate and generate value.

This is not to suggest that the quantifying and valuing of workers' or other stakeholder investments will always be easy. In the absence of specific information before the court,
the court is unlikely to fully value these interests. For example, in the CCAA case of Re Repap British Columbia Inc., the debtor corporation was to be restructured under an arrangement in which workers at the pulp mill would receive 20% of the equity in the restructured corporation. An issue arose as to how the equity was to be allocated among the workers. The corporation and managerial employees successfully argued that it should be divided by wage amount, in recognition of wage concessions made. Two unions argued that it should be on a per capita basis in recognition not only of the wage concessions, but also on the basis of contractual concessions on trade flexibility and contracting out. On the face of the judgement, the Court does not, however, appear to have had any valuation of these other concessions before it. The Court found that it was not in a position to analyze details such as a trust arrangement and income tax considerations and thus made the distribution decision based on wages earned. The British Columbia Court of Appeal refused to grant leave to appeal on the basis that the allocation was unique to the circumstances, the decision of the chambers judge should not be lightly interfered with, and there was no substantial injustice created by the decision. The judgment indicates that absent some means of assigning a value to the interests of workers, in this case contractual benefits that had previously been bargained for and which were compromised under the CCAA, the court is unlikely to look beyond the fixed claims in determining or valuing interest.

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685 Ibid. at paragraph 7. The unions disagreed on the relevant date for determining this.


687 Ibid.
There are a large number of court-appointed officers in bankruptcy and insolvency proceedings. Here I focus on key actors in the decision-making revolving around restructuring, specifically, the monitor under the CCAA, a receiver appointed immediately after CCAA proceedings, and the role of the trustee under the BIA. Some of the considerations set out for these officers can arguably be applied to other court-appointed officers.\(^{688}\)

Prior to the 1997 amendments to the CCAA, the court had discretion and often appointed monitors in CCAA proceedings. In 1997, the legislation was amended to make the appointment of monitors mandatory.\(^{689}\) The statute sets out the duties of the monitor, including, that it shall monitor the company’s business and affairs; have access to and examine the company’s property; file reports with the court on both a periodic and specified basis on the state of the business’ financial affairs; report on any material adverse change in the company’s projected cash flow or financial circumstances; and advise creditors of reports filed with the court.\(^{690}\) The provisions also specify the circumstances in which the monitor is not liable and directs debtor corporations to provide assistance to the monitor necessary to enable it to carry out its functions.\(^{691}\)

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\(^{689}\) CCAA, supra, note 5 at section 11.5. It also specifies that the auditor may be appointed monitor, at section 11.7(2).

\(^{690}\) Ibid. at section 11.7.

\(^{691}\) Ibid.
expertise of monitors has been invaluable in assisting with the development of plans and in performing a monitoring function on behalf of those with an interest in the insolvent corporation. The legislative amendments were thus a codification of the court's practice. The court continues to exercise its discretion to direct the monitor to perform certain functions as it considers appropriate in the circumstances.

Trustees in bankruptcy are insolvency practitioners or accountants who administer cases under the BIA. A trustee must be appointed in all cases under the restructuring proposal provisions of the BIA, their statutory duties as described in part B of this chapter in the discussion of the scheme of the BIA. A receiver, a liquidator or a trustee can file a proposal in bankruptcy but almost all proposals are filed by debtor corporations, naming a licensed trustee in bankruptcy that has agreed to act. The trustee's role under the BIA is one of monitoring and reporting. The trustee has the responsibility to make every effort to realize the maximum return possible for creditors, yet it has a simultaneous obligation to ensure that the debtor corporation receives the protection afforded it under the BIA. Thus a trustee must undertake its activities by acting impartially and by striking an equitable balance between the rights of debtor corporations and the rights of the general body of creditors. Often this is difficult because the trustee is appointed by the debtor corporation, paid out of operating funds and because of the trustee's early involvement in advising the debtor corporation how to utilize the proposal process.

692 In liquidation they are responsible for collecting and disposing of the property of the bankrupt and distributing the proceeds of the property. They can be initially nominated by the debtor corporation, but the appointment must be confirmed at the first meeting of creditors, at s. 16, BIA, supra, note 5.

693 See discussion at supra, chapter 3, part B.

694 Siciliano, supra, note 21 at 1.


696 The trustee has an obligation to discuss options available to debtors, including the advantages and disadvantages of proposals under Part III of the BIA. Mathew Harris, "The Restructuring of Air Atlantic" in Ziegel and Baird, supra, note 6, 537 at 555.
In terms of court-appointed receivers, the Courts have held that the effect of appointing a receiver is to divest the corporation and its directors of their power to manage the business or deal with the property.697 Unlike privately appointed receivers, those appointed by the court are to consider the interests of all parties, not just a single secured creditor. When receivers are appointed after there has been an unsuccessful CCAA application, the receiver still has an obligation to consider the interests of all creditors. Often, in such circumstances, the receiver may have a role to play in facilitating some sort of work out in terms of an asset sale in order to preserve some value in the firm while maximizing value for creditors. Moreover, the receiver must ensure that someone is operating the business in the period after a failed CCAA application and pending a decision about the future of the corporation.

Generally, Canadian courts have accorded considerable deference to recommendations of its court-appointed officers. Where courts have appointed such officers with commercial expertise, the courts have held that they will place a great deal of confidence in the officer’s actions and give weight to recommendations.698 Depending on the role assigned by the court, the court has used tests or principles by which to assess the actions or recommendations of such officers. For example, in Skydome Corporation, the Monitor was directed to co-ordinate the sale process: to ask for expressions of interest in an auction, to arrange for confidentiality agreements in the bid process, to review the offers, to set up an advisory committee of stakeholders, work with it in assessing the offers, and to bring a recommendation to the court.699 These functions were undertaken in the context of CCAA proceedings, but were akin to a receiver in a disposal of assets


699 Skydome Corporation, supra, note 276.
situation. In approving the Monitor’s recommendations, the Court therefore applied the tests used in that analogous situation. Specifically, the Court considered whether the Monitor had made a sufficient effort to obtain the best price and had not acted improvidently; whether the Monitor had considered the interests of all parties affected; the integrity and efficiency of the process by which offers were obtained; and whether there had been any unfairness in the working out of the process. In Skydome, the Monitor had made the recommendation to accept the offer of one bidder with the support of an advisory committee representing Skydome’s major creditors. The Court accepted the recommendation of the Monitor and approved the offer as fair and reasonable.

The role of the monitor and court-appointed officers with similar duties in the restructuring or sale process raises some important governance questions. How the officer undertakes the balancing of interests is crucially important, given the high level of deference by the court to the recommendations of its officers. Insolvency practitioners have pointed out that where the monitor or receiver understands its role to be one of ensuring that all interests are considered, the process tends to be more successful, transaction costs are lower, and there is greater buy-in by all parties, whatever the final outcome of the proceeding. However, where such officers consider primarily the interests of secured creditors or accord little value to the interests of unsecured creditors, workers or other stakeholders, they have not adequately performed their role. The outcome of the proceedings, whether a restructuring or a sale, suffers from this failure because value may not have been maximized or transaction costs may have increased from litigation by those parties that believe their interests were not considered. Thus, the governance role of monitors and other court-appointed officers needs much further

700 Skydome Corporation, ibid. Endorsement (19 February 1999) Ontario Court of Justice (General Division) Commercial List, Blair J.

701 Ibid., citing Soundair, supra, note 698 and Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87 (Gen. Div.).

702 Ibid.

703 Ibid., the successful bidder was Sportsco International Corporation, a consortium that purchased the insolvent stadium for $109 million in a deal that closed in April 1999. Gayle MacDonald, “Sportsco, Labatt caught in Stormy Marriage”, Toronto Globe and Mail (20 April 1999).
consideration. As the discussion in chapters 5 to 8 illustrates, the current practice has been uneven under *CCAA* applications. In some cases, the officer has been instrumental in ensuring that the interests of equity, debt and equitable investors have been carefully considered. In other cases, such as *Med-Chem*, it is unclear that the officer fully appreciated the importance of such a governance role. Morawetz suggests that inherent in the independence of the monitor is that it should consider the voices of smaller interests to whom it also owes an obligation, otherwise, they are unlikely to be heard.\(^\text{704}\)

While it is important that the court is able to defer to the expertise and business judgment of its officers, the court in its supervisory capacity must ensure that the officer is fulfilling its governance role.\(^\text{705}\) Without such judicial oversight, the ability of workers, local governments and other stakeholders to meaningfully participate will depend solely on the particular officer appointed.

It is also important to note the role of insolvency counsel in restructuring cases. Counsel are officers of the court, although they represent the interests of their clients. The Canadian insolvency bar contains highly skilled advocates who have been instrumental in advancing the caselaw to deal with the complexities that arise in *CCAA* applications. Senior counsel often appreciate the importance of considering diverse interests, whether advising the court-appointed officer, the debtor corporation or traditional creditors. For example, Jones and Dixon, in discussing the *Oakwood Petroleum* case, point out that it was essential, in giving advice, to consider the interests of a number of constituencies including workers, directors, shareholders, creditors, governments and the general public.\(^\text{706}\) They point out that the dynamics of the *CCAA* process are such that the party that appears adverse in interest today, may be the key vote in a proposed plan tomorrow.\(^\text{707}\) Morawetz has observed that counsel represent the interests of their clients

\(^{704}\) Morawetz, *supra*, note 627.

\(^{705}\) The Court noted in *Royal Oak Mines Inc.* that the initial order may have disadvantaged stakeholders. The order provided that the debtor corporation or the monitor could apply for directions in relation to the discharge of the monitor’s duties, but did not afford this right to other parties. *Royal Oak, supra*, note 591 at paragraph 27.

\(^{706}\) Jones and Dixon, *supra*, note 629 at 359.
best when they consider all of the interests that are affected by the restructuring decision, interests that the court will also ultimately consider. This consideration of other interests is with the view of finding common ground in formulation of a plan and in enhancing their respective interests.

F. **How the Statutory Scheme of Fixed Claims of Employees in Bankruptcy Affects Corporate Work-outs**

In chapter 2, I suggested that workers are equitable investors such that they should be accorded special participation and decision rights in the restructuring process. One further issue is whether recognized equitable claims of workers would be negatively affected in terms of current priority rights in the case of firm bankruptcy.

Scholars and practitioners have frequently observed that one of the most difficult aspects of the bankruptcy that occurs when restructuring is not possible or economically viable, is the devastating impact of loss of jobs, increased unemployment, and other social and economic adjustment harms. Under the *Bankruptcy and Insolvency Act*, workers currently have limited priority in claims for wages owing in the six months prior to bankruptcy. The *BIA* sets out a hierarchy of claims of secured creditors, preferred

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709 See for example, K.P. McElcheran, “New Rights for Employees-the Wage Claim Payment Act” (Law Society of Upper Canada Conference, Toronto, 1992) at 1. He observes that where Unions are involved, employees are more likely to have their interests represented in the negotiations for restructuring.

710 Section 136(1)(d), *BIA*, *supra*, note 5. There is a live debate about whether workers are voluntary or involuntary creditors and the extent to which they voluntarily assume risk of non-payment. See Davis and Ziegel, *supra*, note 25 at 1.
creditors and unsecured creditors.secured creditors are at the top of the priority list, because the Bla gives title of the debtor's property to the trustee in bankruptcy subject to the rights of secured creditors. Secured creditors are broadly defined, and given that the vast majority of credit to Canadian corporations takes the form of secured credit, they form a large category of classes in any reorganization or liquidation scheme. Workers rank fourth in the statutory priority for creditors after testamentary and funeral expenses of deceased bankrupts, fees and expenses of trustees, and the superintendent's levy. However, the priority for their fixed claims is very limited, allowing preference of claims for wages and salaries owed by the debtor for the six month period immediately preceding the bankruptcy to a maximum of $2,000. The claims for unpaid wages over and above that amount are unsecured claims. This wage preference has little value on liquidation because most often there is insufficient value remaining after satisfying the claims of secured creditors. In one study of pre-1992 bankruptcy, wage earners recovered only 31% of their statutory claims, and only 7% of their unsecured claims. Thus workers have generally been unable to recover many of their fixed capital claims.

There is limited wage protection when the debtor corporation is making a proposal under the Bla. The statute specifies that the court cannot sanction a proposal unless it provides for payment to employees in an amount they would receive under the preferred wage

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711 Sections 136-141, Bla. supra, note 5.

712 Bla. supra, note 5 at section 71(2); see Campeau Corp. v. Provincial Bank of Canada (1975), 54 D.L.R. (3d) 329 (Ont. H.C.J.).


714 Section 136(1), Bla. supra, note 5; and in the case of travelling salespersons, expenses up to a $1,000 (amended from a smaller amount in 1992). The final priority of preferred claims are those resulting from injuries to employees not covered by workers' compensation, section 136(1)(i), ibid. Section 81.1 also provides a statutory scheme for goods and production supplied if a request for return of goods is made under very particular circumstances and conditions are met.

715 Section 136(3), Bla. supra, note 5.


717 Davis and Ziegel, supra, note 25 at 7, tables 3 and 4. They suggest that what recovery occurs is likely a function both of the personal liability of directors under corporations statutes as well as the need of trustees to retain the services of some employees during the wind up of the estate.
claim, i.e. $2,000 and the court is satisfied that the corporation can and will make such payments. This provision is aimed at deterring debtor corporations from filing proposals merely to avoid liability for preferred wage claims.

Similarly, under the Bank Act, employee claims for up to three months of unpaid wages have priority over a bank realizing on security under s. 427 of the Act. However, security under section 178 of the Bank Act has priority over trust and lien claims of employees under employment standards and pension benefits legislation. Chartrand has observed that protection of employees’ fixed claims under provincial legislation is inconsistent across Canada in terms of statutory deemed trusts and director liability.

There has been considerable debate over the priority to be accorded workers’ claims for unpaid wages and pension contributions when a firm is bankrupt, fuelled by recent judicial pronouncements on where workers' claims stand in the priority list. Davis and Ziegel have observed that debtor corporations and secured creditors have benefited from the inability of workers to bargain for a risk premium because secured debt shifts

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718 Section 60(1.3), 136(1), BIA, supra, note 5.

719 Section 427(7), Bank Act, supra, note 305. However, if a bank acts on its general security agreement and not under the Bank Act, employees do not enjoy the section 427 priority, and their claims are relegated to section 136 or unsecured status. Barbara Eccles, “Bankruptcy and Employment Law: A Primer” (Canadian Bar Association Conference on Insolvency Law for the General Practitioner, Toronto, 1999) at 15.


721 He suggests that making directors liable is not conducive to reorganization and that the regime has not addressed the need to create expeditious and effective remedies for employees. Numerous federal committees have for example recommended a national adjustment fund for wage arrears but it has not been implemented because of lack of political will. R. Chartrand, supra, note 716 at 227-8.

bankruptcy related risk from secured creditors towards workers whose preferred wage claims are subordinated to those interests. Moreover, the amount of preferred claims, $2,000.00 is quite small. Thus, as a policy instrument for the protection of workers' interests, this statutory preference is not that beneficial. To date, suggestions that workers should receive some sort of super priority in wage claims has not been able to garner political support.

There have also been suggestions that an alternative policy instrument is necessary, such as a national insurance scheme in which wage claims up to a prescribed limit would be paid where the assets of the corporation were not sufficient to satisfy such claims. Such a scheme was proposed by the Federal Government in 1991, including financing by small premiums paid by employers exclusively or by employers and employees jointly. However, there was such vigorous opposition to the proposed scheme that the Government did not proceed. While it appears that such a scheme has merit, practically it does not appear to be on the horizon in terms of legislative change. There are provisions in some provincial statutes for wage earner protection, but these tend to be very uneven across Canada. In Ontario, wage protection legislation was enacted by one Government in 1991, only to be repealed by the subsequent Government a few years later. As a consequence it is even more compelling that workers be afforded an opportunity to bargain what they can in the negotiations for a restructuring.

Employment standards legislation specifies and the courts have held that an employer is deemed to have terminated employees on bankruptcy. Directors are jointly and severally personally liable for up to six months of unpaid wages (excluding severance

723 Davis and Ziegel, supra, note 25 at 2, 9. The corporation may receive more favourable terms of credit without compensating workers for the shift in terms of additional risk of bankruptcy related losses. However, they conclude that granting workers super-priority for wages will negatively affect the supply of credit to particular types of Canadian corporations and suggest that this area receive further examination.

724 The proposed Wage Earner Protection Act, Bill C-22, did not even receive the support of the Government's own elected caucus member and was thus abandoned. Ziegel et al, supra, note 2 at 701.

725 Ibid. Chartrand, supra, note 716.
and termination pay) if the corporation is insolvent, and a claim made to the receiver or trustee in bankruptcy is unpaid, or if an order has been made pursuant to the Employment Standards Act. They may also be liable for pension contributions. Thus, directors have some incentive to ensure that wages are paid, particularly if special trust funds have not been set up to cover statutory liability, including workers' wages in the event that the corporation becomes insolvent.

Thus the effect of bankruptcy on employment contracts is that individual contracts are deemed terminated by bankruptcy. However, treatment of collective agreements is more complex. If the business is sold as a going concern through bankruptcy, then labour legislation has found the sale of a business and declared the purchaser bound to the collective agreement. Even when only the assets are sold, "sale of business" or "related employer" provisions have been applied, resulting in collective agreements being applied to the purchaser. Therefore, the change in the identity of the owner through an automatic bankruptcy liquidation does not result in termination of a collective agreement.

In terms of considering the framework proposed in chapter 2, some might argue that fixed claims would or should disappear if workers are found to be residual claimants. However, such an argument fails to account for both the fixed and residual claims of workers, and fails to recognize the value in having complementary policy instruments to protect workers ex ante investments in the firm. Moreover, even within the narrow restructuring context, this dual claim status is not antithetical to current corporate law. For example, an equity investor might also have a secured debt with the corporation. In the case of bankruptcy, that shareholder would have the same rights as other secured

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726 Section 57 (2.1) Ontario ESA, supra, note 415 was amended in 1995 to make clear that an employer is deemed to have terminated employees on bankruptcy. Section 57(2.1) Ontario ESA, as amended, 1995, supra, note 415. Re Rizzo & Rizzo Shoes Ltd. (1998), 50 C.B.R. (3d) 163 (S.C.C.)

727 Ibid. at s. 58.20. The ESA applies to directors only to the extent that directors are relieved of their liability to pay wages to employees of the corporation under subsection 108(5). OBCA, R.S.O. 1990, c.B.16; CBCA, supra, note 5. These provisions do not apply to Part III corporations under the Corporations Act or to companies to which the Co-operative Corporations Act applies.

728 Davis and Ziegel, supra, note 25 at 7.
creditors to the extent of the secured debt, this being distinguishable from her or his lower priority as a common shareholder. Similarly, the current legal structure can accommodate the fixed claims of workers, while still recognizing their equitable interest. However, the current paradigm under which the enforcement of fixed claims operates is likely to affect the court’s view of exactly what decision or control rights should be accorded.

In the restructuring context, often workers’ fixed capital claims are satisfied if the firm requires the continued human capital investment of workers. Thus, the debtor corporation or the receiver may agree to pay wage and other fixed claims as inducement to workers to continue their human capital investment during the negotiations for a workout. Court appointed receivers or trustees in bankruptcy who continue to operate the business may also incur liability. In *St. Mary’s Paper Inc.*, the Court held that the trustee, by carrying on the bankrupt’s business, retaining employees after bankruptcy and making contributions to the pension fund, was liable for all deficiencies in the pension plan under the Ontario *Pension Benefits Act*.

It is increasingly common for large companies to establish trust funds to cover prospective liabilities to employees and/or indemnities for directors. This is to encourage directors to remain or to attract new directors. However, Ziegel points out that trust funds indemnifying directors for wages to employees may run into difficulties under the voidable preference provisions of the *BIA* if they are established too close to the

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729 Ibid.

730 Generally the courts have held that privately appointed receivers are not successor employers for purposes of employment and labour law because they are agents of the debtor corporation. The exception is that they may be liable for employment standards claims that accrue in the period that the receiver operates the business. *Irving Oil v. Moquin* (30 April 1998) N.B. J. No. 139 (N.B.C.A.). In contrast, court appointed receivers have been found to be successor employers within the meaning of successor provisions of provincial labour relations statutes if the receiver continues to operate the business for any period of time before moving to sell the business or liquidate. Chartrand, *supra*, note 716 at 212, 213.

corporation’s bankruptcy. In Re Westar Mining the initial stay order permitted a trust fund to be maintained. The fund was created prior to filing a CCAA application to cover the liability of directors for employment standards claims. However, when the amount of liability exceeded the trust fund and directors sought indemnification for the liability through security, the Court refused to sanction continuing payments into a trust fund after the initiation of proceedings under the CCAA. Its rationale was that such approval would reorder priorities, would prejudice Westar’s other creditors and give preferred treatment to one class of creditors. The Court recognized that its decision might jeopardize the CCAA process but it determined that to grant the order would substantially change priorities in favour of workers’ unsecured claims if the reorganization failed. Courts, in engaging in the balancing of all interests therefore are unlikely to enhance the priority of workers' wage claims over other creditor's claims.

The courts have recognized that the preferred statutory claim for workers is only partial compensation for their losses. In Rizzo, the Supreme Court of Canada measured the extent of employees' investments by the length of their service with the corporation, holding that fixed claims for severance were some compensation for the employees' investment in the business and some compensation for the years of service lost. The issue of the value and priority to be accorded workers’ fixed wage claims needs further study. More importantly, consideration of other policy instruments such as a national wage protection insurance scheme needs to be evaluated in terms of whether this would prove more effective in protecting workers from the harms and adjustment costs associated with firm failure. Moreover, such an instrument would complement as

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732 Ziegel et al, supra, note 2 at 747.
734 Ibid.
735 Ibid.
736 Re Rizzo & Rizzo Shoes Ltd., supra, note 726.
737 Such a scheme could also apply to labour shedding in insolvent firms, as well as where firms amalgamate, merge, shut down or move. In such cases, it would provide more uniform protection of workers' lost investment than any change to the insolvency regime.
opposed to replace my proposed framework. However, the current trend in Canada and other jurisdictions is away from such remedial schemes.\textsuperscript{738} Given this trend, the ideas contained in this thesis are even more timely because they do not require statutory amendment and because they offer one means of protecting human capital investments.

\textbf{G. Environmental Issues and Governance of Insolvent Corporations}

The statutory scheme of bankruptcy and insolvency addresses a component of the "public interest" in the way in which it deals with the question of environmental liability and the governance decisions during insolvency. This area has become very significant because of the failure of governments to enforce environmental protection legislation for many years, leading to the creation of environmental harms when the corporation was solvent. More recently statutory amendments have imposed director and officer liability for environmental harm. Thus, a key governance issue of the 1990's is environmental liability and the obligations of various parties at the point of insolvency. For example, in the case of \textit{Royal Oak Mines Inc.}, which filed an application under the \textit{CCAA} in 1999 and then was put into receivership, the environmental liability for clean up costs for arsenic trioxide was estimated at $50 to 250 million.\textsuperscript{739} If the corporation had been successfully restructured, the new owners would have been responsible for clean up. Now that the

\textsuperscript{738} J. Sarra, "Protecting Workers' Equitable Investments in the Firm, Viewing Corporate Governance Reform Through the Lens of Dismantled Government Infrastructure" (LL.M. Thesis, Faculty of Law, University of Toronto, 1998), Part I.

\textsuperscript{739} Allan Robinson, "Taxpayers may face giant clean up bill: arsenic dust in Royal Oak Mine will cost millions to get rid of", Toronto Globe and Mail (20 April 1999) at B3.
company is in receivership and there will be a sale of assets, it is likely that federal
depthies and thus taxpayers will be liable for the clean-up costs.740

The environmental liability issues pose some important challenges for the restructuring
regime. Often at the point of insolvency, all of the outstanding environmental issues that
the corporation has been deferring for years come to the fore. This is in part because the
liability runs with the land, and creditors and others may be reluctant to move to enforce
their claims where they are uncertain of the amount of liability they face. Part of the
difficulty is determining who will bear responsibility for clean-up costs and other
environmental liability under both remedial environmental protection legislation and
common law. Creditors, managers and other stakeholders must necessarily consider the
risks of environmental liability in considering whether or not to restructure.
Environmental protection legislation has been strengthened considerably in the past two
decades, imposing personal and corporate liability for environmental harm. For example,
environmental liability may be such that it impairs the ability of the debtor corporation to
pay its debts, thus precipitating insolvency.741 Similarly, tort claims arising out of
environmentally related harm may force the corporation into insolvency. Uncertainties
about the extent of liability may hinder the corporation’s ability to obtain further
financing for restructuring.742

Creditors face the risk of acquiring environmental liability. A creditor such as a
mortgagee, while technically having some degree of ownership, does not exercise any
charge, management or control over the debtor corporation’s activity and thus is likely

740 Clean up estimates vary because no one has undertaken a detailed examination of the clean-up costs. There is currently leakage in one or two of the fifteen underground chambers where the arsenic is being stored. The contaminated water is currently being pumped to the surface to prevent leakage into fresh water lakes, however, a long-term clean-up solution is required. Ibid.


742 Ibid. at 8.
not liable for environmental harm prior to realization. However, once a lender realizes on the security, the issue is whether the mortgagee as new owner is responsible for environmental clean up and compliance. Usually a receiver or receiver-manager is appointed under the security agreement and there is often an indemnity given by the creditor to the receiver.

Prior to 1992, lenders, trustees and receivers were potentially liable under federal and provincial environmental protection laws for costs associated with environmental protection and remedial measures. The environmental protection statutes impose liability on persons deemed to be “in charge, management or control” over the source of contaminants. Thus trustees and receivers had been reluctant to become involved with businesses who faced potentially high environmental liability, thereby defeating some of the underlying purposes of environmental protection legislation. In some cases, creditors sought court orders to appoint a receiver to realize on the assets of the corporation but without authority to take possession of or manage the assets and asked courts to expressly order that such appointment did not deem the receiver to acquire ownership or control such that it would incur environmental liability.

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745 McLaren, supra, note 37 at 7.2600. The initial cases regarding liability were unclear. For example, while the courts held that trustees could not be liable under the (then) Bankruptcy Act, they left open the possibility that they could be found to be personally liable under the “person responsible” provisions of environmental legislation. ibid. at 7.2650. As a result, such officials tended to refuse to deal with companies that had the potential of environmental liability.

746 See for example, the Ontario Environmental Protection Act, R.S.O. 1990, c. E. 19, as amended, at section 7.

747 McLaren, supra, note 37 at 1.1550, 7.2650.

748 Royal Bank of Canada v. Oil Canada Ltd, supra, note 526.
In 1992 the *BIA* was amended to give trustees in bankruptcy protection against environmental liability provided that they take steps to ensure that no further environmental damage occurs to the premise in question. The standard was one of due diligence, not defined in the statute. This resulted in trustees still being reluctant to take possession of and clean-up contaminated sites.749 Prior to 1992, receivers, interim receivers and lenders who were appointed to deal with the property for the benefit of creditors could be deemed to be in care and control of the property and thus liable for environmental damage.750 In some cases, the creditors seeking appointment of receivers tried to limit environmental liability of receivers by having the court specify such protection in the court order appointing the receiver.751

Further amendments to the *BIA* in 1997 clarified the scope of protection and circumstances in which liability may be found for trustees.752 The 1997 amendments also extended protection from environmental liability to receivers and interim receivers in limited circumstances.753 The *BIA* now specifies that protection from liability is given to trustees, trustees in a proposal under Part III, receivers, interim receivers, and receivers

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749 Section 14.06(2) of the *BIA*, 1992, c. 27 (then) at section 9(2) specifies that notwithstanding any provisions of federal and provincial environmental protection legislation, a trustee is not personally liable in its capacity as trustee for any environmental condition or damage that arose before the trustee was appointed, or after the trustee was appointed except where the condition or damage occurred as a result of the trustee’s failure to exercise due diligence. McLaren, *supra*, note 37 at 7.2700.

750 *Panamericana de Bienes y Servicios, S.A.* v. *Northern Badger Oil & Gas Ltd.* (1991), 81 D.L.R. (4th) 280, supp. Reasons, 86 D.L.R. (4th) 567 (Alta C.A.), leave to S.C.C. refused 86 D.L.R. (4th) viii, in which the Court held that a receiver was liable for the costs of abandonment to render oil and gas wells environmentally safe. Provincial law was found to be general law regulating the safe practices of oil and gas wells and thus not in conflict with federal bankruptcy legislation. See also *Bank of Montreal v. Lundrigans Ltd.* (1992), 92 D.L.R. (4th) 554 (Nfld. S.C.) in which a receiver was found liable for environmental conditions.


752 *BIA, supra*, note 5.

753 McLaren, *supra*, note 37 at 1.1600. Trustees obtained unlimited indemnity from large creditors or government enforcement agencies. Receivers and interim receivers come under the definition of section 243(2) of the *BIA, supra*, note 5.
within the meaning of section 243(2). The statute exempts these officials from personal liability for environmental liability that arose before their appointment, thus, hopefully encouraging these officers to take control over contaminated sites.

Environmental liability is also an important consideration in determining whether to approve a plan to restructure the corporation. Since these costs are often unknown at the point at which a debtor corporation seeks restructuring under insolvency legislation, this can pose a barrier to successful restructuring. Where a creditor exercises any control over the operation or management of the debtor corporation’s business, it may be subject to liability. For example, if a creditor in a private work-out or in negotiations for a restructuring requires that the corporation direct particular resources towards repayment as opposed to clean-up, this could be interpreted as “control” and carry with it extensive environmental liability. The availability of credit may be affected when the value of the security is reduced by environmental liability. If the security is contaminated or a public danger, the security may be valueless.

Moreover, often creditors appoint members to the Board of Directors as a condition of restructuring and refinancing. Those directors then acquire environmental liability. The same applies to workers, shareholders, unions or community members who may be appointed directors, depending on the degree of ownership or control they exercise. Directors can be held responsible under provincial and federal environmental protection legislation for acts of the corporation that result or are likely to result in discharge of a

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754 McLaren, ibid.

755 Section 14.06(2), BIA, supra, note 5. McLaren, ibid. at 7.2850.

756 Harbell and Boddez, supra, note 744 at 1.

757 Ziegel et al, supra, note 2 at 756.

758 Harbell and Boddez, supra, note 744.
Directors have a positive obligation to ensure that all reasonable care has been taken to prevent such discharge. The courts have held that reasonable care may include at a minimum, a requirement that directors have addressed the issue of pollution prevention through the set up of systems and practices. Reasonable care will also be assessed on whether directors: reviewed environmental compliance reports; undertook oversight of concerns raised by government agencies or other parties; demonstrated an awareness of industry standards regarding risks; developed remedial and contingency plans for spills; implemented an ongoing environmental audit system; ensured training; and whether they took any direct action in the event of a system failure. The Ministry of the Environment can issue preventive orders, removal of waste orders, orders addressing the effects of a discharge, and in cases of immediate danger to human life or health, a control or stop work order. These orders may be directed at current as well as previous owners. The owner or person in control who is responsible for a discharge is liable not only for clean-up costs, but also loss or damage associated with any adverse effect on the environment and on third parties. They may also be liable for costs of remedial work done by the Ministry of Environment where the urgency has required those officials to take emergency steps to clean up the problem. There is also potential civil liability.

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759 See for example, the Ontario Environmental Protection Act, R.S.O. 1990, c. E-19 at sections 6, 7, 14, 15, 17 and 90; the Ontario Water Resources Act, R.S.O. 1990, c. O-40; the Canadian Environmental Protection Act, R.S.C. 1985, c.16.

760 Shareholders may also face such liability as owners or persons in control of the corporation, ibid. at 2.


762 Harbell and Boddez, supra, note 744 at 37.

763 Tay, supra, note 741 at 3, 4.

764 Harbell and Boddez, supra, note 744 at 8.

765 Ibid. at 9.

766 Tay, supra, note 741 at 5.

767 Harbell and Boddez note that civil liability actions include nuisance, strict liability for environmental harm, negligence, and trespass, as well as statutory civil causes of action for loss or damage, citing section 99, EPA, supra, note 744.
Thus, in decisions about converting debt to equity in a restructuring or exercising enhanced oversight, a live issue is the environmental liability that creditors may be acquiring, particularly if there is some element of being a "person responsible" for source of the contaminant. Part of the governance debate in restructuring therefore, is an assessment of the risks incurred by various parties and how that may affect the decision to restructure. The existence of a "green plan" of environmental policies, properly structured audits and effective implementation and follow up systems should be minimum requirements in terms of financing decisions.

In Ontario, the practice has arisen that creditors lending additional capital can enter into lender liability agreements with the Ontario Ministry of the Environment in which the creditor agrees to pay a portion of the clean-up costs in the event that an order is made by the Ministry. In exchange, the lender is entitled to be able to conduct an environmental investigation without being deemed to be in charge, management or control, and is entitled to recover a portion of the amount of the loan even if the work did not remedy all of the environmental problems. This willingness of provincial environmental authorities to work with lenders is an effort to balance environmental clean up with the ability of lenders to recover. It is also to encourage having the property cleaned up and sold rather than being abandoned.

For example, in the Algoma Steel case, the Provincial Government offered some protection for the operating lender as consideration

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768 Defined as owner, person in occupation, person having the charge, management or control of a source of contaminant, and may include previous owners or occupants. Harbell and Boddez suggest that shareholders are therefore not entirely protected from environmental liability by the corporate veil, supra. note 744 at 40.

769 Ziegel et al, supra, note 2 at 757.

770 McLaren, supra, note 37 at 7.2800.

771 Harbell and Boddez, supra, note 744 at 32.
for it extending a further bridge loan of $60 million. Default would have granted possession rights without attracting any environmental liability.\footnote{Marantz, supra, note 12 at 10-11.}

One objective of the 1997 amendments extending liability protection to receivers and interim receivers is to encourage creditors to take possession of contaminated property, to undertake comprehensive environmental assessments, and take steps to reduce environmental harm to the public.\footnote{McLaren, supra, note 37 at 7.2850.} Trustees, receivers and interim receivers will only be liable for environmental damages that have occurred after their appointment if their conduct with respect to environmental maintenance or protection constitutes willful misconduct or gross negligence, a lower standard than the previous one of due diligence.\footnote{Ibid. at 7.2850.}

Moreover, the statutes now expressly address the issue of environmental orders issued prior to the appointments of trustees, receivers and interim receivers. Such officers now have the right to: abandon or divest themselves from the property affected by the condition or damage; to apply to obtain a stay from the provincial authority or body issuing the order or having the power to grant a stay; or to apply to court for a stay of enforcement of the order.\footnote{Section 14.06(4), (5), BIA, supra, note 5.} They can also apply to the court for a stay in order to assess the economic viability of the bankrupt and whether the costs of compliance with the order outweigh the realizable value of the property.\footnote{Thus encouraging them to undertake the assessment without fear of being found in charge or control and ultimately encouraging them to take possession of properties that are contaminated. McLaren, supra, note 37 at 7.2900.} The aim is to encourage creditors, through their officers, to consider taking steps to remedy the environmental problems instead of abandoning the property.\footnote{Ibid. at 7.2850.} Ultimately, however, the trustee, receiver or
interim receiver can decide that abandoning the property is in the best interests of creditors and may do so without incurring liability. Since environmental costs are not considered administration costs, the costs of environmental clean-up do not rank ahead of other claims in priority to any distribution to other parties of payouts of other assets.

The 1992 amendments also resulted in converting secured Crown claims for environmental clean-up under provincial legislation to unsecured claims if the corporation becomes bankrupt. Thus the Crown was left with the costs of clean-up of environmental contamination with no recourse to recover from the parties responsible for the contamination. The 1997 amendments sought to remedy this problem by specifying that a claim of the Crown for environmental clean-up costs is given priority over all other charges on the real property affected and any other real property that is "contiguous thereto" which will come into effect on bankruptcy. Thus remediation costs related to environmental damage will be paid out of the net proceeds of the realization of property. Moreover, the 1997 amendments addressed what had been a prior problem of determining how much contamination was caused before or after the date of bankruptcy. Now a claim for remediation of environmental damage will

777 Ibid. at 7.2900. McLaren notes that these provisions also avoid the lengthy process of negotiating lender agreements on environmental liability.

778 Moreover, if the property is abandoned, the costs of environmental clean-up do not rank as costs of administration s. 14.06(6), BIA, as amended, supra note 5. McLaren, supra, note 37 at 7.2900.

779 David Baird, "Environmental Liability, Bill C-5 Amendments to the BIA and the CCAA" (Canadian Bar Association Conference, Toronto, 1997).

780 Section 86, BIA, supra, note 5. McLaren, supra, note 37 at 7.2950.

781 McLaren, ibid. at 7.2950.

782 Section 14.06(7), BIA, supra, note 5. Those arguing against such amendments argue that such a priority by the Crown will hinder the ability to find credit given that the Crown will take priority over a secured creditor in the event of environmental contamination of the property. McLaren, ibid. at 7.2950.

783 While the Task Force on bankruptcy reform, the BIAC Task Force, had recommended that such priority extend also to intangible property located on the contaminated site, the legislators declined to enact that priority. McLaren, ibid. at 7.2950.

include damage occurring both before and after bankruptcy, thus avoiding the problem of ascertaining when the contamination occurred.\textsuperscript{785}

The language of remedial environmental statutes makes clear their public interest goals. For example, stop orders can be issued where the corporation is discharging into the environment any contaminant that constitutes an immediate danger to human life and health.\textsuperscript{786} Orders for clean-up, repair or prevention can be issued where a person has caused or permitted discharge of a contaminant into the natural environment resulting in injury, damage or endangerment of land, water, property, animal or plant life, human health or safety.\textsuperscript{787} Existence of such orders may be a determinant of whether a restructuring is viable. It may also be a significant indicator of governance problems with existing officers and managers.

In terms of any restructuring agreements, creditors now seek representations and warranties relating to the corporation's compliance with environmental law, continued reporting and compliance.\textsuperscript{788} This can also include covenants regarding future activities in terms of compliance with environmental protection laws, as well as indemnification of the creditor from any costs arising as a result of environmental liability.\textsuperscript{789}

\textsuperscript{785} Section 14.06(8), BIA, supra, note 5; see also McLaren, supra, note 37 at 7.2950.

\textsuperscript{786} Section 8, EPA, supra, note 759.

\textsuperscript{787} Section 17, ibid. In R. v. Sault Ste. Marie, the Court held that "cause" means an active undertaking of something which it is in a position to control and which results in pollution; "permitting" means the person's passive lack of interference or failure to prevent an occurrence which it ought to have foreseen, (1978) 85 D.L.R. (3d) 161 at 184.

\textsuperscript{788} Harbell and Boddez, supra, note 744 at 28.

\textsuperscript{789} Ibid. at 30. They point out that given that it is often only on insolvency that a lender may wish to rely on the indemnity, creditors are advised to obtain indemnities from related parties such as parent corporations of the debtor, and to require that any indemnities run longer than the term of the loan.
Thus, the scheme attempts to balance a number of competing interests in terms of environmental protection, creditor liability and the ability to successfully restructure. There is the public interest in terms of ensuring that someone is taking responsibility for environmental protection at a time when the governance of the corporation is in disarray. In turn, this may result in a restructuring plan that crafts a viable solution to the environmental problems that have been highlighted as the result of the insolvency. This benefits all stakeholders.
CHAPTER 4

ONTARIO’S CASE-MANAGED SYSTEM:
A PROTOTYPE FOR EFFECTIVE JUDICIAL OVERSIGHT
OF RESTRUCTURING OF INSOLVENT CORPORATIONS

Co-operation, communication and common sense are the three commercial court canons driving Ontario’s case-managed process

Mr. Justice Farley
Ontario Superior Court of Justice,
Commercial List, 1997

The Ontario case managed process under the CCAA has allowed parties to have an expeditious resolution to applications for restructuring. There are a number of reasons for this: use of judicial direction to order the stay and set the appropriate conditions of that stay; use of pre-trial settlement efforts; liberal access to the case managing judge to resolve disputes without a formal hearing; use of mixed affidavit and vive voce evidence, and encouragement of negotiation and mediation. An effective restructuring system is based on whether there is access to the court to resolve disputes between the parties. Even in restructuring regimes which are primarily commercially driven, the availability of the court and its legislated mandate to resolve disputes and keep the issues moving, is key to efficient achievement of a restructuring plan.790

790 American law Institute, supra, note 33 at 3, 4.
Scholars and practitioners have pointed out that an effective restructuring system is premised on the availability of the court in the process. While restructuring should focus on the commercial viability, the ability of parties to seek direction or have disputes resolved, ensures that the process of negotiations continues. It is not whether the majority of cases are resolved in or outside of the court-supervised process, but rather, the existence of a structured framework means that the failure to resolve issues can be remedied by the courts' mandated role of facilitating the process. In Canada, insolvency legislation is administered by the superior courts in each province, and orders made in one provincial jurisdiction under the CCAA are of full force and effect in other provinces.

The Ontario Superior Court of Justice, Commercial List, is a prototype for effective judicial oversight of restructuring proceedings. The description in this chapter of the expertise of the Court and efficacy of its case-managed system highlights why the Court has been so effective in complex restructuring cases and why insolvency practitioners prefer to bring CCAA applications to this Court whenever they can successfully argue the jurisdiction of the Court. This discussion sets the stage for chapters 5 to 8 in which I discuss four very recent cases and how the Court has exercised effective judicial oversight. It is this oversight, combined with the expertise of the judges, that has resulted in a series of cases that support some of the ideas contained in my proposed framework.

A. The Uniqueness of the Ontario Process

The Ontario case-managed system offers two unique qualities not found in most other jurisdictions. First, there is the existence of the Commercial List in Toronto, which is

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791 Another example is the Chancery Court as an effective business court in the United Kingdom, with its system of "quick turn around", promptness, and consistency. Celia Cohen, "The Appeal of the Chancery Court", American Lawyers' Law News Network (16 March 1999).
not a separate court, but nevertheless is a separate court office and process, a part of the Ontario Superior Court of Justice. The second distinction is the "hands-on" nature of the Court itself in all matters before it, but particularly in matters relating to corporate restructuring. The key elements of the case-management system include facilitating or ordering negotiation, expeditious access to the case-managing judge, and the issuing of interim orders to keep the process both expeditious and accountable.\footnote{An example of this was in the Bramalea restructuring. There was an issue of U.S. creditors attorning to Canadian jurisdiction. The parties were able to negotiate an agreement with respect to these creditors, and the Court was asked and agreed to lift the stay. \textit{R. G. Marantz, "The Reorganization of a Complex Corporate Entity: The Bramalea Story" in Ziegel and Baird, supra, note 6 at 1.}}

By way of comparison, in British Columbia, there is no commercial list or specialized bench although several judges with considerable corporate expertise are routinely assigned to \textit{CCAA} cases.\footnote{McRae, \textit{supra}, note 10 at 105.} Those judges undertake case management in the sense that the assigned judge hears all motions relating to that case or related cases. However, it is not case management in the sense of "real time litigation", which is using the power of the court to move the process along to arrive at a plan of compromise or arrangement on a very timely basis, commensurate with the business exigencies of the insolvent corporation and the impact on stakeholder interests.\footnote{Tay, \textit{supra}, note 461.} One advocate has suggested that the lack of a roster of judges assigned exclusively to hear insolvency cases means that the success of a restructuring in British Columbia is in part "luck of the draw".\footnote{McRae, \textit{supra}, note 10 at 105.} In Alberta, some members of the court have contributed their commercial expertise and have been instrumental in advancing the law and facilitating restructurings, but there is no specialized part of the court assigned to such matters.\footnote{Most notably Justice Forsyth. Tay, \textit{supra}, note 461 at 201 and 211.} Similarly, in Quebec, there is not a specialized bench, but rather, there are several judges with corporate/commercial expertise who are assigned to many such cases.\footnote{R. Langlois, "The Story of Steinbergs" in Ziegel and Baird, \textit{supra}, note 6, 491 at 506.} Access to these judges is becoming
more difficult because of an increasingly diversified bench.\textsuperscript{798} In Atlantic Canada there have been problems with a lack of informational capital in terms of both the parties and the courts.\textsuperscript{799}

The principal merit of the Ontario Commercial List case-managed system is that matters can be dealt with fairly, expeditiously and efficiently. The proceedings under the CCAA are more expeditious than those under U.S. Chapter 11 proceedings as matters are often completed in three to six months instead of two to seven years.\textsuperscript{800}

The Commercial List judges have experience, interest and expertise in corporate/commercial matters.\textsuperscript{801} The objective is to provide well reasoned decisions, effective management of the case, and expeditious decisions on interim issues, given their understanding of the issues and problems which arise in restructuring proceedings. To this end, many matters in CCAA cases are listed and dealt with in days if not hours. The Court has stressed that the Commercial List is not a separate court and that while its objective is to develop a specialized commercial expertise, it will rotate generalist judges on and off the list.\textsuperscript{802} However the Court has also stated that in the case of insolvency proceedings, stakeholders should feel confident that they will be supervised by experienced judges.\textsuperscript{803}

\textsuperscript{798} Yoine Goldstein, telephone interview (16 August 1999).

\textsuperscript{799} Lorraine King, "Wandlyn Inns Ltd.: A New Brunswick Restructuring" in Ziegel and Baird, \textit{supra}, note 6 at 213.


\textsuperscript{802} \textit{Ibid.} Some insolvency counsel are unhappy with this. They suggest that the rotated judge just comes up to speed on the procedures and caselaw and they are rotated out again. Thus they argue that the rotation period should be longer.

\textsuperscript{803} Mr. Justice Farley, "The Judges Speak: A Panel Discussion" in Ziegel, \textit{supra}, note 105 at 757.
The Commercial List hears cases in considerably less time than the court’s regular trial list. The reason that this can be accomplished is that the Court requires that parties adhere to its practice direction, which sets out fairly rigorous requirements.\textsuperscript{804} The new Practice Direction for the Commercial List became effective January 1, 1996.\textsuperscript{805} The operating premise is that parties will have considerable input into the process and time frame of a restructuring application, but that once the process is in place, the Court will expect parties to adhere to both the letter and the spirit of the case management schedule that has been set. The Practice Direction was created and revised after considerable consultation with the insolvency Bar. Accordingly, there is a high level of co-operation in meeting the requirements and in assisting in the expeditious processing of restructuring cases.\textsuperscript{806} Given the exigencies of expeditious decision-making at the point of insolvency in order to prevent the further depletion of value for creditors, these practice directions assist parties with timely resolution of disputes. Moreover, from a pragmatic view, the Commercial List encourages parties to send their comments and criticisms to the Commercial List Users Committee, an advisory committee that continues to advise the Court on how to improve its accessibility and efficiency.\textsuperscript{807}

A Trial Requirements Memorandum is required to be filed with the Court for all cases before the Commercial List, specifying parties involved, chronology of events leading up to the litigation, and a corporate diagram. The parties must also file a Compendium/Documents Brief, a Witness List, any evidence in Chief that will be given by affidavit, and an Agreed Statement of Facts where possible. In \textit{CCAA} cases, this involves fairly full disclosure of the financial situation of the corporation so that

\begin{footnotesize}
\begin{enumerate}
\item[804] Peter Griffin, “The (Almost) New Practice Direction of the Commercial List” (CBAO Conference, Commercial List: Knowing the Court and How to Use It", Toronto, 1997) at 2.
\item[805] The first practice direction was published on August 8, 1995. Dennis O’Connor, “Playing by the Rules Makes Life Easier” (CBAO Conference on Commercial List, Toronto, 1997). The Rules have been revised in 1999, but have not yet received approval.
\item[807] Paul LeVay, “Commercial List Practice Direction” (CBAO Conference, Toronto, 1997) at 2.
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stakeholders are able to make timely and informed decisions about their support for a possible restructuring.

The Court has also created very liberal access to: “9:30 appointments”. These are ten-minute meetings with the case managing judge in chambers to resolve matters of scheduling, minor disputes on disclosure, consent matters, and simple directions. The Court may actually endorse an order or just give informal but clear directions to the parties to ensure the process keeps moving forward. Often 9:30 appointments are booked the day before or frequently occur on a “walk-in basis”. Although the supervising judge will deal with ex parte motions on an urgent basis, the justice will likely refuse to do so where the matter is not urgent. Parties frequently use these 9:30 appointments to resolve matters and keep the schedule on track. They also use them to seek advice and direction from Court on various issues involved in the CCAA proceedings, obviating the need to bring formal motions and thus increase transaction costs in the CCAA application. The Court, however, is rigorous in its direction to counsel that it will not decide matters where adequate notice has not been given to interested parties, or where the matter should be properly decided in a public hearing. This informality combined with serious regard for the rules of natural justice creates a forum where workers, local governments and other "new parties" to restructuring proceedings can be assured of notice and a reasonable opportunity to be heard. The discussion of Red Cross and Anvil Range in chapters 6 and 7 are particularly illustrative of this. As a result, there tends to be fewer adjournments of formally scheduled hearings.

The schedule set in CCAA cases, tries to allow for all anticipated motions and pre-trial requirements. All of these are aimed at fostering pre-trial settlements or a narrowing of issues before they come before the Court. The parties are required to attend pre-hearing conferences, both for case management and to report on settlement talks. The pre-trial

808 Ibid.

809 Practice Note, supra, note 804. Justice Epstein, Ontario Court of Justice, Remarks (CBAO Conference, "Commercial List: Knowing the Court and How to Use It", Toronto, 1997).
judge facilitating any settlement discussions does not sit on the case at trial, thus encouraging parties to be candid in their settlement and mediation efforts. For practical purposes the judges do not undertake formal mediation, however, they use their expertise and mediation skill techniques in pre-trial settlement conferences.

The Practice Direction also specifies a list of matters that may come to the Commercial List. Only Toronto region matters can be listed on the Commercial List, unless for special reason the supervising judge gives authorization. In reality, the Court hears a number of cases quite removed from the Toronto region because the head office of one or more of the principal parties is located in Toronto. The Anvil Range case is one in point. Although the CCAA case dealt with operations located in the Yukon, affecting about 20% of the Gross Domestic Product of that territory, the matter was litigated in Toronto before the Commercial List. Counsel have also suggested that the effective case-managed system results in counsel seeking Commercial List hearings in CCAA applications whenever they can. The Court may exercise its discretion to hear the case if the matters are complex corporate/commercial matters with considerable impact. The sheer complexity of financing arrangements in many CCAA cases often enables parties to come before the Commercial List.

All applications for restructuring are case managed. The Commercial List has encouraged numerous strategies to keep parties moving toward development and approval of a plan of arrangement or compromise. Examples include directing common service lists; regular counsel meetings; by encouraging regular reporting to the court through both cost effective written reports or letters; through court appearances where


811 O'Connor, supra, note 310 at 3.

matters are contentious; and refusing to schedule trial dates and thus commit further resources of the Court where the judge is not satisfied of the parties' progress.  

Case reporting conferences are frequently held in open court, and the Court can be quite vigorous in questioning parties' progress in the negotiation for a workout. For example, in the recent case conference in the *Loewen CCAA* application, Mr. Justice Farley asked a number of pointed questions regarding the efforts of the debtor corporation to develop a viable business plan and co-ordinate the Ontario proceedings with U.S. *Chapter II* Bankruptcy Code proceedings. This was notwithstanding the fact that all the creditors at the hearing fully supported the debtor corporation's efforts. The Court advised the parties of the need for some flexibility on the part of both U.S. and Canadian courts, but reminded the parties that the interests of multiple creditors and minority interest holders in 800 Loewen related companies, as well as more than 13,000 employees were affected by the corporation's decisions at each stage of the proceedings. The Court was highly effective in extracting a number of commitments from the debtor corporation to expedite resolution of the issues, and where possible, expedite the U.S. proceedings. Such measures are effective in resolving issues and in facilitating the participation of multiple stakeholders while trying to contain costs.

The case managed process also allows the court to engage in timely resolution of disputes as they arise. In Cadillac Fairview, where several stakeholder groups had restructuring proposals, the Court ordered that the corporation be given exclusive authority to develop a plan for an initial period, during which time parties advancing other proposals were to submit them to the debtor corporation. The corporation was to consider amendments to reflect those proposals, was required to establish an information room to allow

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814 *Loewen, supra*, note 800, *Case Conference Hearing* (12 August 1999), (O.S.C.J. (Com. List)), Farley J.

815 *ibid.*
stakeholders to review the proposals, and the debtor corporation was given the exclusive right to file a proposed plan before a prescribed date. Other plans could not be filed until after this process. What the Court was able to do was thus to ensure that the debtor corporation was given an opportunity to come up with an acceptable plan, requiring it to take account of the proposals of other stakeholders and setting a strict time frame for compliance in order to ensure that a plan was developed and approved in a timely fashion, notwithstanding multiple and divergent interests.

In Royal Oak Mine Inc., when a majority of secured creditors moved to end the CCAA stay and place the corporation in receivership, the Court rigorously scrutinized the company’s request for an extension of stay and fixed it for a limited ten day period, warning that there would be no further extensions. The Court controlled the process, but still had regard for the objectives of the legislation. Subsequently, when the corporation could not devise a restructuring plan acceptable to creditors, the Court granted a request to place the corporation in receivership.

Another example of the Court being both flexible and expeditious was a case in which Mr. Justice Farley granted an injunction over the phone, without a motion record before him, ordering Bell Canada to turn a debtor corporation’s phone back on. Without the order, the company would have gone out of business. In Red Cross, one motion to lift a stay was held quickly and cost effectively by a video conference hearing between Toronto and Ottawa. Similarly, in the successful restructuring of Ball Packaging,

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816 Goldberg, *supra*, note 488 at 50.


818 *Ibid.*, Endorsement of Farley J. (18 April 1999). Another example is in Bramalea, Mr. Justice Houlden periodically lifted the stay of the proceedings when parties had negotiated and the company had agreed to quit claim or relinquish its interests in numerous properties, in order to allow creditors to exercise their remedies in respect of those properties. Marantz, *supra*, note 792 at 19.

819 The Court dismissed the motion, but the parties were able to argue the matter before the Court in an expeditious and cost effective manner. *Canadian Red Cross*, (23 April 1999), Ontario Court File No. 98-CL-002970, (Ontario Superior Court of Justice, (Commercial List)) Blair J..
Counsel have suggested that it was in large measure due to the flexibility of both the CCAA and the Commercial List that the plan was proposed, voted on and implemented in a matter of days, notwithstanding many complexities in the case. The flexibility of the Court combined with its concern for balancing the interests and prejudices illustrates that it is well situated to consider the interests of diverse stakeholders that I have proposed in chapter 2.

The case managed process under the CCAA is particularly suited to complex cases. It allows for a more active role on the part of the judiciary, more co-operation between the court and counsel, and use of a broad spectrum of dispute resolution techniques. For example, *Olympia & York Developments* involved 29 affiliated corporations. In that case, the Court made more than 70 orders during the CCAA process from May 1992 to February 1993 in its capacity as case manager. The orders included resolution of numerous issues between the creditors, including approval of a novel approach towards operating and administrative expenses pending the plan's approval; funding and representation orders; approval of the structure of creditors' committees; confirmation of sale of certain assets of the debtor companies; approval of classes for voting purposes; endorsement of the information circular and notice for the final proposed plan. The Court also ordered an "information officer", a novel idea that allowed a court-appointed officer to prepare information reports on cash flow and financial affairs of the corporation to creditors and the Court, while simultaneously avoiding the costs of appointment of a monitor. The Court also appointed a claims officer at the request of the parties, and a

820 Dunphy, *supra*, note 10 at 256.
821 *Olympia & York, supra*, note 442 at 8. Yoine Goldstein *et al.*, "Olympia and York: Navigating Uncharted Waters" in Ziegel and Baird, *supra*, note 6, 151 at 164. Geoffrey Morawetz reports that to July 1999, there have now been more than 200 orders in this case, *supra*, note 663.
822 Colloquially known as "GAR financing" (General, administrative and restructuring financing. Goldstein *et al.*, ibid. at 162.
823 *Olympia & York, supra*, note 442 at 8.
824 Goldstein, *et al., supra*, note 821 at 157-8. The appointment of a Monitor has been mandatory since 1997.
retired judge was given discretion to set a procedure and determine contested creditor claims and make cost determination awards, thereby saving court time and resources. Parties could appeal to the Court, although the process was so successful it was unnecessary. The ability of the Court to deal effectively with multiple and complex creditor interests supports my assertion that it is equally well situated to balance the interests of non-traditional creditors and stakeholders. Clear direction, use of mediation skills, and creating alternative processes within the Court's case-managed process, are all strategies to enhance participation, control transaction costs and account for multiple interests. The Court is well situated to exercise effective oversight of a CCAA proceeding of the type that I advocate.

The Court has also encouraged pre-packaged CCAA applications where appropriate and where the debtor corporation has been able to gain the support of creditors. The Court has encouraged early disclosure and early negotiations with all affected parties as a means of expediting the process and thus enhancing the possibility that a plan can be successfully negotiated. Early disclosure and negotiation may enhance the ability of workers and other equitable investors to participate because it ultimately reduces costly court appearances.

Under the case managed process, the Court has also been willing to give parties direction for future cases. The recent direction by the Court to simplify the language and content of initial stay orders in CCAA applications is a good example of this. In Royal Oak Mines Inc. the Court expressed concern about the increasing practice of formulating complex initial stay orders and failure to give adequate notice. It advised the debtor corporation that plain language and better notice to parties of the nature of more extensive relief that may be sought shortly would be helpful to stakeholders in allowing

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825 Ibid. at 170.

826 In Armbroro Enterprise Inc. (1993), 22 C.B.R. (3d) 80 (Gen. Div.) the initial filing contained a plan of arrangement under both the CCAA and CBCA, the debtor corporation having already negotiated and received substantial creditor support. The plan was approved by creditors and sanctioned in 38 days. Geoffrey Morawetz, "Armbroro: The Bumpy Road to Recovery", in Ziegel and Baird, supra, note 6 at 559.

827 Re Royal Oak Mines Inc., supra, note 591 at paragraphs 20 to 22.
them to consider their positions and to know what is likely to come before the court. The aim is to balance expeditious decision making with the ability of parties to be able to assess the information and formulate their positions. Subsequently, the Court approved a plainer language version of an initial stay order in Loewen Group Inc., an indication that the parties have taken note and will work to comply with the new directive.

This direction by the Court for better notice and plainer language can only assist workers, small trade suppliers and other non-traditional creditors who may be seeking participation rights. This is particularly so in terms of adequate notice. Given that workers’ claims are viewed as fixed, as discussed in chapter 2, often the debtor corporation does not give the workers or their union notice of CCAA proceedings. For example, in each of the cases of Anvil Range, Red Cross and Royal Oak Mines Inc., the workers and their unions were not given any notice of the proceedings until some discreet issue of pension liability, other fixed claims, or stays on grievance arbitration proceedings arose. Often at this stage, important decisions have already been made, including the court’s sanction of detailed initial stay orders that stay the rights of employees and limit the liability of court-appointed officers in terms of employment and labour law. While workers can take advantage of the “come back” clause, in reality, most workers do not have the sophistication to appreciate any remedies that they may have because of failure of the debtor corporation to give notice.

Moreover, as Justice Blair recently concluded in Royal Oak Mines Inc., the "come back" clauses in initial orders do not provide an answer to “overreaching” initial orders because while there is no formal onus on the party seeking to vary the initial order, the momentum established in the process creates an inherent disadvantage to the party having to rely on these provisions. This observation by the Court is important for

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828 Ibid.
829 Loewen Group, supra, note 800.
830 Michael Kainer, interview (20 July 1999).
831 Royal Oak Mines, supra, note 591 at paragraphs 27, 28.
stakeholders seeking participation rights for the first time. Early notice and disclosure to non-traditional creditors and stakeholders can facilitate the early identification of their interests and allow them to seek to enforce what participation and decision rights that they can establish.

B. Use of Alternative Dispute Resolution

As in most matters before the Ontario courts, there is currently a trend towards Alternative Dispute Resolution (ADR). The Commercial List Practice Direction specifies that ADR is recognized and encouraged in Commercial List matters. This was the first such written directive issued by a Canadian court. The judges on the Commercial List are available to assist with settlement discussions and to conduct case conferences with the view to settling or narrowing the issues between the parties in the case. Mr. Justice Farley has stressed, however, that generally, ADR should only be attempted where the parties agree that there is a viable enterprise that can be salvaged.

ADR is multifaceted, the most important type comprising direct negotiations between parties with an interest in the insolvent corporation. The Commercial List Judges have frequently reminded parties that timely negotiation and resolution of disputes in CCAA applications is more effective than proceeding in court, and that the Court will facilitate negotiations to ensure that they take place on a principled basis.

832 O'Conno, supra, note 310 at 7. The court also encourages the use of outside mediators and retired judges who specialize in mediation of commercial matters, as a means of conserving use of court resources. If the pre-trial or settlement process is likely to be lengthy, the parties must satisfy the Court that they have already made serious efforts to settle the matter prior to the Court agreeing to use its resources, that materials are prepared or will be prepared, and that there is some reasonable prospect of settlement.

833 Mr. Justice Farley, supra, note 803 at 763.

834 See for example, Mr. Justice Farley in Royal Oak Mines Inc., supra, note 613 at paragraph 15.
Use of formal ADR as a tool of Ontario's case managed process has generally only been used on consent of the parties. An exception was the Algoma Steel case, discussed at length in chapter 5. There, the Court, in an effort to facilitate the outstanding financing issues, ordered the parties to mediation in January 1992. The parties had already agreed that the business plan was viable. The Court held that given that Algoma was Sault Ste. Marie's largest employer and that "there would be no reason for the city to exist without the company", mandatory mediation was called for.835 While the banks initially took the position that the Court did not have the jurisdiction to issue the "ADR" order, they agreed to participate when the process appeared to be workable.836 While the ability of the Court to order mediation was never tested, the Ontario Court has consistently taken the view that part of its inherent jurisdiction is to ensure the expeditious processing of cases. It is unclear whether or not the banks would have been successful in any challenge to the Court's jurisdiction in this respect. The Court has exercised its inherent jurisdiction to order procedures and processes that create access to the negotiations and dispute resolution. Such orders include the setting up of information rooms, sanctioning mediation processes for the settlement of specific claims in the CCAA proceeding, and setting out confidentiality regimes.837 Thus, there is no reason why court-ordered mediation would not be appropriate in some circumstances, particularly if parties are supportive but dealing with a reluctant creditor.

The jurisdiction of the Court to order ADR may be clearer in 1999 than it was in 1992 because the Ontario Court system has created a scheme of mandatory mediation. While the Commercial List is not included in the Ontario mandatory mediation process because of the specialized nature of commercial matters, there is no question that the courts are moving in this direction. What is very interesting is that the successful mediation in the Algoma Steel CCAA case was the genesis for the current ADR regime. Given the

835 Ibid. at 763.

836 McCartney, supra, note 31 at 245.

837 See for example: Red Cross, supra, note 819; Skydome, supra, note 276; Cadillac Fairview, supra, note 561.
effective resolution in *Algoma Steel*, the Ontario Government set up an ADR centre in the Court, created a pilot mediation project and ultimately in 1999 implemented a broad-based scheme of mandatory mediation for almost all civil proceedings in Ontario.

The use of ADR and mediation skills in *CCAA* proceedings is important to my conceptual framework for the restructuring of insolvent corporations. The Court’s willingness to consider and balance the complex interests of multiple stakeholders may support the ability of non-traditional creditors to participate in such proceedings without unduly adding cost or delay to the process. The Court is aware of the problems of cost and its barrier to participation. Moreover, the Court’s willingness to facilitate expeditious resolution of disputes can assist workers and others at risk of loss of their equitable investments. Legislation is only as effective as the access to the process designed to fairly and expeditiously resolve disputes. Here, the Court’s practices have gone a long way towards recognition of this.

**C. The Ontario Court’s Role in Harmonizing with Other Statutory Schemes**

Any protocol across jurisdictions depends to a high degree on the good will of the parties and the even-handedness and fairness of the protocol. If the protocol favours one jurisdiction or the other, it will not receive the requisite support to make it effective.

Mr. Justice Farley, 1999
Ontario Superior Court of Justice Commercial List

Canadian courts, as with their American counterparts, have tried to harmonize proceedings that propose restructuring of insolvent corporations. There are two aspects to

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638 Mr. Justice James Farley, Ontario Superior Court of Justice (Commercial List). Interview (12 August 1999), quoted with permission.
this, first is harmonization with other provinces and the second is with international bankruptcy jurisdictions. The first appears to have been resolved with recent statutory amendments. Previously, if an Ontario court issued a stay order or sanctioned a proposal or plan, the parties would seek recognition orders in other relevant provincial jurisdictions, creating costly additional legal proceedings. At least one court has now held that the statute has obviated the need for companion orders in other provinces.

The second aspect, harmonizing cases with international jurisdictions is key given the important role of multinational corporations in the Canadian economy. The courts and the international insolvency bar led the legislation in attempting to set up protocols. In particular, Mr. Justice Farley of the Ontario Superior Court of Justice was instrumental in advancing cross-border insolvency law. For example, in Everfresh, both Canadian and American courts in the initial orders directed the parties to have regard for proceedings in other jurisdictions, both subsequently approving a cross-border protocol based on the work of the International Insolvency Bar Concordat. These orders dealt with co-ordination and co-operation in the administration of the proceedings, co-ordination in ongoing operations, asset sales and distribution, claims filing procedures and choice of law issues, and co-ordination of development of plans in both countries. Bruce Leonard observes that this dramatically reduced the cost of litigation and placed the focus on restructuring issues instead of conflicts of laws disputes.

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839 In 1990, the Supreme Court in Morguard Investments Ltd. v. De Savoye [1990] 3 S.C.R. 1077 made clear that the treatment of other provincial jurisdictions as “foreign” was out of step with Canadian commercial realities. This opened up the willingness of the courts to recognize the jurisdiction of foreign courts where the jurisdiction has a “real and substantial” connection with the CCAA proceedings before the Canadian court. Bruce Leonard, “The Everfresh Reorganization: Advancing Co-operation in Cross Border Insolvencies” in Ziegel and Baird, supra, note 6 at 330.

840 The 1997 amendments have now set out provisions for international protocol, S.C. 1997, c. 12, section 118, adding Part XIII to the BIA and section 18.6 to the CCAA.

841 For a discussion of the International Bar Association Committee “J” Cross-Border Insolvency Concordat, see Leonard, supra, note 839 at 331-334.


843 Ibid. at 339.
One cross-border insolvency tool has been endorsement of companion orders. The court endorses the plan within its own jurisdiction, and the order contains a paragraph that it seeks and requests the aid and recognition of U.S. courts. For example, the Ontario Superior Court of Justice has held that it has jurisdiction to approve a protocol worked out between parties under United States Chapter 11 proceedings, in order to resolve conflicts between CCAA plan provisions and claims by U.S. creditors to American real estate assets. In Olympia & York Developments, the debtor corporation had filed concurrent applications under Chapter 11 of the U.S. Bankruptcy Code and under the CCAA. The protocol dealt with a mediation process to decide corporate governance issues for various parties that held interests in U.S. real estate, including appointment and functioning of boards of directors, indemnity and immunity provisions and recognition of rights of the administration. The U.S. Bankruptcy Court had sought to strike a balance between the corporate governance provisions of the CCAA plan and the necessity of achieving a Board of Directors that was able to function independently. While the Ontario Court was not prepared to accept that it would oust its own future jurisdiction, it did indicate that it would be inclined to defer to the jurisdiction and decision of the U.S. Bankruptcy Court in the matter of U.S. law. The Court found that it had jurisdiction based on the principles of international comity between nations and the Court’s inherent jurisdiction to ensure the observance or due process of law, and to do justice between the parties. In the Olympia & York

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844 In Olympia & York, it was used to facilitate GAR funding, Goldstein, supra, note 798 at 164.

845 Ibid. at 164.


847 Goldstein, supra, note 798 at 154.

848 Olympia & York, supra, note 846 at 168.

849 Ibid.

850 Ibid. at 169. It noted, however, that the mechanism for resolution of issues between the two courts was not clear.

Developments case, the U.S. Bankruptcy judge had first approved the protocol.\textsuperscript{852} It provided a means to implement the CCAA plan, which provided "certainty" regarding cross-jurisdictional issues. The Canadian Court observed that cross-border insolvency disputes are becoming increasing frequent, and that courts should try to facilitate the resolution of cross-border disputes, whether substantive or procedural differences are at issue, and that such co-operation is consistent with the court's own fundamental principles of jurisprudence.\textsuperscript{853} The Court held that the protocol was a fair and reasonable resolution of contentious issues arising from the clash between CCAA provisions and concerns of U.S. creditors regarding U.S. real estate assets.\textsuperscript{854} As Goldstein and others have pointed out, the expertise and competence of the respective judges in Canadian and U.S. jurisdictions resulted in the issues being processed effectively without having to determine the difficult question of primacy of jurisdiction.\textsuperscript{855}

Leonard has pointed out that multinational enterprises operating profitably are accustomed to global management in terms of decisions about resource allocation and going-concern business decisions. Yet when a multinational corporation approaches insolvency, multinational scale management disappears and with it the ability to make fast decisions.\textsuperscript{856} The corporation must deal with different creditors, different priorities in different statutory schemes, and the usual conflicts between stakeholders are exacerbated by conflict of law issues.\textsuperscript{857} What exists to facilitate restructuring and other insolvency questions are notions of either primary/secondary jurisdiction or concurrent proceedings. Primary/secondary proceedings are those where the restructuring application is filed in

\begin{footnotesize}
\begin{enumerate}
\item Order of Judge Garrity, U.S. Bankruptcy Court, Southern District of New York, \textit{Bankruptcy Code}, 11 U.S.C., the Court relying on its jurisdiction to make any order necessary to carry out the provisions of the U.S. \textit{Bankruptcy Code}, s. 105.
\item \textit{Olympia & York Developments, supra}, note 846 at 167.
\item \textit{Ibid.} at paragraph 6.
\item Goldstein, \textit{supra}, note 798 at 164.
\item Leonard, \textit{supra}, note 839 at 325.
\item \textit{Ibid.} at 326-7. Leonard points out that as long as negotiations for bilateral treaties remain in the realm of sovereignty interests instead of commercial interests, this avenue for the resolution of multinational insolvency problems is unlikely to be successful.
\end{enumerate}
\end{footnotesize}
one jurisdiction where the debtor corporation's central operations are located, with secondary subsequent filings in jurisdictions where assets are located. Concurrent jurisdiction models involve the debtor corporation filing in both jurisdictions simultaneously.858

Both the CCAA and the BIA were amended in 1997 to expressly empower the Canadian court to make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under the CCAA with any foreign proceedings.859 The court has the discretion to enforce or decline to enforce any order made by a foreign court, and the court is expressly empowered to seek the aid and assistance of a foreign court or other authority where it considers it appropriate.860 These statutory amendments codified the development of the common law in cross-border restructuring applications.

The use of cross-border protocols is in its infancy. The most recent development arising out of the evolution of protocols is the conducting of "joint hearings" of Canadian and U.S. Courts in restructuring applications.861 Such hearings allow parties on both sides of the border to have the benefit of making submissions and hearing the questions and concerns of the Court without the "filter" of reading their views in foreign judgements. It allows the courts to send signals to parties with respect to restructuring issues that concern the court's particular jurisdiction and allows the judges to directly communicate instead of only through written judgements and orders. Given the time sensitive nature of restructuring proceedings it may expedite decisions, cut costs in terms of numbers of

858 Ibid. at 327.
859 Section 18.6, CCAA, supra, note 5.
861 An example of a joint hearings was Livent in Ontario, and in Solv-x before Mr. Justice Forsyth in Alberta.
court appearances, and facilitate decisions that have pragmatic and practical effect in both jurisdictions.

The development of protocols and cross-border hearings is so recent that parties have yet to fully explore what can be accomplished through such protocols. Given their nascent state, it is not clear yet what the implication will be for the "public interest" component of CCAA proceedings. Notions of what is in the public interest differ from jurisdiction to jurisdiction. Thus it may be that cross border protocols facilitate the meshing of diverse notions of the public interest. Bruce Leonard has observed that parties are so busy determining how to use such tools that public interest concerns have not been considered.\textsuperscript{362} One can only speculate as to whether such developments will facilitate or hinder some of the features of the system I have proposed. However, given the Ontario Court's clear message to parties about having regard to all interests at risk in the insolvent firm and given its highly effective case management process, it is likely that any attempt by non-traditional creditors to seek participation or decision rights in cross-border cases will be met by the same willingness of the Court to at least consider those interests and to weigh them in the balancing under the CCAA.

\textit{D. Conclusions}

The case-management process at the Ontario Superior Court of Justice Commercial List has proven an invaluable tool in the expeditious and cost-effective resolution of restructuring applications. In addition to the highly skilled justices that bring their commercial expertise to CCAA proceedings, there is also strong support by the insolvency bar for the efficient resolution of cases through the processes designed by the Court. Triantis characterizes this as a "compact between its judges and the insolvency

\textsuperscript{362} Bruce Leonard, interview (3 August 1999).
bar that commits them to eschew procedural game playing, encourage negotiation, and promote the speedy resolution of disputes".  

Practitioners have expressed support for the merits of the case-managed process when used in conjunction with the CCAA as a restructuring tool, including: flexibility of the Court; expeditious access to the case-managing judge; the willingness of the Court to make a variety of orders and to make effective use of ADR strategies. Without this flexibility in both the statute and the Court, numerous restructurings would not have been possible.

The process also works best when there is broad disclosure by the parties, facilitated by orders of the court. Trust and co-operation is perhaps the most important element and this can be encouraged by the case-managing judge. Numerous practitioners have suggested that where there is not co-operation between stakeholders from the outset, often those corporations are doomed to failure, either initially or after the restructuring has taken place. Use of mediation and negotiation as alternative dispute resolution techniques are often facilitated by the Court’s urging of the parties to resolve as many matters as they can between themselves. The availability of the Court on short notice for 9:30 appointments and under the “come back” clause which is a standard part of stay orders, means that where parties have failed to resolve issues, they can have an expeditious disposition of the issue, thus clearing the way for further negotiations.

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863 Trianitis, supra, note 1 at 114.

864 It is useful to note that this endorsement of the legislation and the flexibility is not restricted to Ontario, see for example Tysoe, cited in Ziegel and Baird, supra, note 6, discussing the successful reorganization of Quintette, at 396; O’Kelly on Silcorp, supra, note 6 at 490; Tay, supra, note 6 at 211; McRae suggesting that the length of stay of 5 months was what was pivotal in the successful Northland reorganization, supra, note 6 at 105.

865 Marantz, supra, note 792 at 22.

866 Ibid. at 22.

867 Goldberg, supra, note 15. Latham, supra, note 468.
This commitment to "real time" litigation has allowed stakeholders to proceed in a timely manner, and has permitted the parties to deal with *CCA* applications at a pace that meets business exigencies.\textsuperscript{868}

\textsuperscript{868} McElcheran, *supra*, note 709 at 83.
CHAPTER 5

RECOGNITION OF THE HUMAN CAPITAL INVESTMENTS OF WORKERS: ALGOMA STEEL CORPORATION

The CCAA is designed to be remedial legislation and it is clear that many (including their professional advisors) have had a very positive hand in perfecting this remedy – Algoma itself, its workers, unionized and salaried, Dofasco, the banks and other debt holders and creditors, and the governments of Ontario and Canada... without the co-operative foundation building of all of you... the collapse of Algoma would have had a devastating effect.

Justice Farley, 1992 869

The case of Algoma Steel Corporation stands out as the most important example of the CCAA process, not only recognizing the interests of stakeholders other than traditional creditors and shareholders, but in supporting my assertion in chapter 3 that the success of corporate restructuring is often largely due to the co-operation of creditors, employees and governments. Some practitioners have observed that a large measure of the successful reorganization in the Algoma case also had to do with the support and intervention of a provincial government sympathetic to workers and the maintenance of jobs in northern communities.870

869 Algoma Steel Corporation, supra, note 663 at 2.

870 Fred Myers and Edward Sellars, Interview (12 January 1999).
Algoma Steel ran into serious financial difficulties in 1991. It faced a huge long-term debt load, increased global competition, removal of trade barriers, unfavourable exchange rates, competition from plastic and aluminum substitutes, reduced domestic consumption, and rapid technological change in steel production. Market prices were flat and Algoma's market share declining, yet it required substantial capital investment in order to become competitive in world markets. In January 1991, the parent company of Algoma Steel, Dofasco Inc., announced that it would no longer provide financial assistance to the corporation and as a result it became insolvent.

The corporation sought protection under the CCAA in February 1991. At the time, the debt of the corporation was $700 million with $75 million in annual carrying costs. The impact of the shutdown on the northern Ontario community of Sault Ste Marie would have been 6,000 direct jobs and an estimated 23,000 spin-off jobs. Lost revenues and displacement costs in terms of training, compensation and lost tax base to governments were estimated at $550 million. At the time of the filing, labour relations were extraordinarily strained as the result of a 112-day work stoppage in 1990 because of labour disputes regarding downsizing, contracting out, severance payments and the question of indexing of pensions.

The initial CCAA stay was granted on February 18, 1991, allowing the company five months to file a plan of compromise or arrangement. The initial restructuring plan

871 Quarter, supra, note 366 at 108.
872 Ibid. at 111. Capital expenditures in 1990 were only 11.5 million dollars.
874 Delaney, supra, note 365.
875 Steve Boniferro, Area Co-ordinator, Northwestern Ontario, United Steelworkers of America, interviews (28 January 1998), (11 June 1998) and (2 September 1999), now Executive Vice-President Algoma Steel Inc. in charge of Industrial Relations.
876 Quarter, supra, note 366 at 111.
877 Court File Doc. No. B62191-A (Ont. Court General Division). With the most recent amendments, an initial stay of that long is no longer permitted. S. 11(3), CCAA, as amended, 1997.
proposed by the parent corporation Dofasco, included: shutting down three out of four of Algoma's production lines, closing its iron ore mine and sintering facility, cutting 2000-3500 jobs immediately with additional substantial workforce reductions by 1995, reduction of the company's $250 million pension liability by converting most of the liability into shares and seeking exemption from liability for environmental clean-up estimated at between 75 and 200 million dollars.\textsuperscript{878} The proposed plan included a provision that workers would receive minority shareholdings in return for major wage concessions. The Union representing the workers, the United Steelworkers of America, opposed the initial proposed plan.

The initial restructuring proposal posed the problem of workers and the community being required to bear a higher degree of risk in corporate restructuring than equity holders, managers or institutional lenders. Massive downsizing, reduction in product lines, little capital expenditure, and reduction of liability through a conversion of debt and liability into shares, left a number of stakeholders highly vulnerable. Employees were asked to take substantial wage cuts in exchange for shares, but without any voice in decision-making at the board or the shop floor level. At the same time, more than one third of the workforce was to be cut, with additional cuts the following year. Employees were being asked to contribute their human capital and equity capital in exchange for a work environment that continued to be hostile to employees and high risk in terms of job security. Moreover, the proposed exchange of pension liability for shareholdings would exacerbate this situation of workers tying up much of their human and equity capital in the firm. The Corporation wanted to reduce its exposure to liability under the provincial government's Pension Benefits Guarantee Fund.\textsuperscript{879} The proposal would have shifted risks previously borne by the Corporation to the workers, placing their future income at risk as well. The community was also being asked to acquire a higher portion of the risk. There were additional costs to the municipal tax base from the reduction of operations, loss in purchasing power of workers, loss in taxes, and increased numbers of people who

\textsuperscript{878} Quarter, supra, note 366 at 112-3, 118.

\textsuperscript{879} Ibid. at 113.
would likely become dependent on municipal services such as social assistance.\(^\text{880}\) In addition, the community would bear the risk of any outcomes from the waiver of environmental clean-up liability that the Corporation was seeking from the provincial government.

The United Steelworkers' previous experience with worker buy-outs in the United States had taught it that without change to governance practices to allow workers to participate in business decisions, they are left with much of the risk and little protection.\(^\text{881}\) The United Steelworkers' announced that it would prepare an alternative to the corporation's proposed plan and the Court extended the date for filing of the plan and stay of proceedings until October 31, 1991.\(^\text{882}\) The Court authorized further temporary financing of $40 million to be provided by the Royal Bank, secured by receivables and inventories, and by guarantees of $10 million each by the Ontario Government, Dofasco, the bank and the workers (funded by wage and salary reductions from July to October 1991 which were placed in a trust fund).\(^\text{883}\) The Union took some leadership in bringing the stakeholders together. This was extraordinary in that most worker buy-outs are typically initiated and co-ordinated by managers, with employees buying in.\(^\text{884}\) The Union used industry and banking experts with experience in American worker buy-outs to craft an alternative restructuring proposal based on a sound business plan.\(^\text{885}\) The Union's objective was two-fold; to create wealth for investors, but equally, to expressly set an objective of sustaining jobs for members.\(^\text{886}\)

\(^\text{880}\) Ibid. at 122. Algoma Steel was at this time 20% of the city's tax base.

\(^\text{881}\) Delaney, supra, note 365.

\(^\text{882}\) McCartney, supra, note 873 at 240.

\(^\text{883}\) Ibid. at 240.

\(^\text{884}\) Hansmann, supra, note 359 at 599.

\(^\text{885}\) Boniferro, supra, note 875.

\(^\text{886}\) Dofasco's reaction to the Union's proposal was that it wanted to walk away entirely from its investment. The Union insisted that the Company couldn't, because it would still have the pension and environmental liabilities even if it abandoned its investment. It was this statutory liability and intervention of the Court that forced Dofasco to the bargaining table. Delaney, supra, note 365.
The Union effectively used its negative bargaining power, the withholding of its agreement to any restructuring plan that would completely devastate its workforce, to push parties to use its restructuring strategy as the basis of discussions."887 While far from enamoured with the Union’s initiative, the major creditors agreed to participate because it was a better option than bankruptcy."888 The Corporation needed government guarantee of an operating line of credit above the $180 million already secured, and the banks understood that the then NDP government would not consider it without the Union at the bargaining table."889 A negotiating protocol was established and a co-determination structure agreed to after the intervention of an Ontario General Division Judge under the case managed process of the Commercial List."890 Moreover, the case management Judge was key in exercising judicial oversight and keeping the parties accountable for their statutory obligations during the process. The negotiations were also assisted by a new CEO willing to negotiate with the Union, and a restructuring expert appointed as Chair of the Board and Chief Restructuring Officer, approved by all the major stakeholders."891

A. Court Ordered Mediation as a Key Element in the Successful Restructuring of Algoma Steel

The Court expressed strong support for the need to restructure the corporation and was forceful in encouraging the parties to come to the bargaining table and negotiate. As discussed in chapter 4, when negotiations between the various stakeholders were stalled

887 The outstanding wage, pension and other claims gave them some degree of bargaining power. Ken Delaney points out that it wasn’t until the banks realized that the Steelworkers would rather watch the plant close than accept a restructuring that gutted the workforce and imposed major wage concessions without governance changes, that it agreed to bargain. Then, a 40% write off appeared more attractive than a complete write off of their investment. Ibid.

888 Quarter, supra, note 366 at 119.

889 Delaney, supra, note 365.

890 Boniferro, supra, note 875 at 4.

891 Gary Lucenti and oil industry executive Earl Joudrie, respectively. Quarter, supra, note 366 at 119.
and the outstanding issues appeared to have reached a stalemate, Mr. Justice Farley ordered the stakeholders into mediation with (then) Mr. Justice George Adams. The Court noted that the parties to the negotiations had conceded to the court that the proposed business plan was feasible, and that the key outstanding issues related to the financial contributions that would be made by the various key stakeholders. Mr. Justice Farley ordered the parties to meet with Mr. Justice Adams in a process which he described as “akin to Court annexed ADR (alternative dispute resolution).” The Judge held that ordering the parties to undertake ADR and to work toward a practical deadline of the following weekend, was because of the “special circumstances of the vital importance of Algoma to the essential viability of Sault Ste. Marie as a major Northern Ontario Community.”

Mr. Justice Adams conducted five days of mediation, meeting individually with stakeholder parties, small groups, and giving reports at plenary meetings. The success of the process was in measure due to the mediation skills he brought to the exercise, assisting the banks and the union to craft an outcome acceptable to all stakeholders. The multi-faceted negotiation/mediation process also included the intervention of then Premier Bob Rae in an effort to assist parties to reach a compromise. The result of two intensive weeks of mediation was an agreed Plan of Arrangement that the Court was able to sanction and for which the parties had high buy-in. The amended Plan was filed on March 11, 1992 and the subsequent meetings of shareholders and creditors resulted in votes of greater than 95% in support of the plan. The Court approved the plan of

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892 McCartney, supra, note 873 at 245.
893 Ibid. at 245.
894 Ibid., quoting Justice Farley at a hearing on February 14, 1992, at 245.
895 Ibid.
896 Ibid. at 245. Mr. Justice Adams had just recently been appointed and was a former Chair of the Ontario labour Relations Board.
897 Ibid. at 246.
arrangement on April 16, 1992. The key role played by the Court in ensuring expeditious proceedings, and in encouraging the parties to use all the dispute resolution mechanisms available, is evidence of the effectiveness of the case-managed process.

Mr. Justice Farley has written that one of the most significant aspects of the Court’s involvement in Algoma was its ability ‘to encourage’ the parties to negotiate and to exert every effort to reach a compromise, using court-involved ADR to assist with dismantling traditional walls between parties such as bankers and union representatives. While normally the Court would rely on the consent of parties to mediate, there may be occasions in which the Court is willing to order ADR where the Court believes that the presence of a neutral mediator assists with finding a solution.

The use of court-ordered ADR was significant in the Algoma Steel case. It set a precedent not only in that it was the first time the Court had ordered ADR in a restructuring, but because its use recognized the legitimacy of the involvement of workers and their unions in the actual negotiation of the plan. Given my assertion in chapter 2 that workers are uniquely situated in terms of the informational and organizational capital that they bring to the restructuring exercise, the Court’s willingness to force parties to consider their interests is vitally important. In my view, this opened the door for cases such as Anvil Range and Red Cross, which are discussed in the next two chapters. There, the debtor corporations and traditional stakeholders did not oppose the involvement of workers, unions and other stakeholders. Their co-operation and willingness to negotiate clearly takes place in the context of an understanding that the Court encourages negotiation with these stakeholders.

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899 Mr. Justice Farley, supra, note 803 at 764.

900 Ibid.
B.  *Co-determination as an Integral Part of the Restructuring Plan*

The terms of the restructuring and take-over of Algoma Steel were elaborate, involving a partnership arrangement between workers, managers, creditors and the Ontario government as loan guarantor. The corporate restructuring was based on eight principles: that Algoma must restore all lines of business to profitability; that employees were to become majority owners; that the Government would enact legislation to facilitate and expedite worker ownership; that there be an injection of capital into a programme to upgrade the plant; that the Government would provide bridge pensions to facilitate workforce reduction without layoff; that Dofasco pay a share of the restructuring; that Algoma would be a "responsible corporate citizen" and not compromise the environment; and that there be government funding for a local Training and Economic Development Council to upgrade employee and management skills. The premise was that the short-term costs of economic transition were considerably less than the long-term cost of major layoff, employee displacement, loss of equity and creditor losses.

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903 Quarter, *supra*, note 366 at 130. Algoma Steel needed to remain in its existing four products markets in order to stay viable. Given declining products markets and rise in competition, restructuring was required to ensure their viability. The restructuring plan agreed to keep all production lines open, but specified that Algoma would not subsidize any operation not contributing cash flow and value. Subsequent to the purchase, the Corporation made a decision to close the iron ore operation at Wawa in 1998, however, as is discussed below, this was decided in conjunction with, and with buy-in from, the workers and the Union.

904 The government enacted the *Employee Share Ownership Plan Act*, R.S.O. 1990, c. E.10, (repealed 1997, S.O. c.19), and *Labour Sponsored Venture Capital Corporations Act, supra*, note 362, however, the workers at Algoma were unable to take advantage of the legislation because they contributed equity through wage cuts instead of capital. The Ontario government did pass securities amendments to allow for the issuing of stock to conform with securities legislation.

905 Boniferro, *supra*, note 875 at 8.
Debenture holders other than Dofasco received new preferred shares in a subsidiary of Algoma Steel, Algoma Finance Inc., for 60% of their secured claims and common shares in Algoma for the balance of their interest.\textsuperscript{906} These shares of Algoma Finance were secured by a floating charge on property and assets of the corporation and agreement by Algoma to purchase the preferred shares if specified default events occurred.\textsuperscript{907} Specified unsecured creditors and preference shareholders received common shares under the plan, and amounts owing to preferred creditors as well as specified trade suppliers were reduced.\textsuperscript{908}

Workers and salaried staff took a 14.5% decrease in annual salaries, as well as cuts in vacation.\textsuperscript{909} The employees acquired a 60% equity ownership in the corporation. In the first five years of restructuring, all employees who worked at least 1,800 hours received an equal number of shares, regardless of their wage rate. Disposal of the shares during this period was restricted to the greater of five years or permanent separation from the Corporation through resignation, retirement or permanent layoff.\textsuperscript{910} The shares are held and voted in two trusts by the Union, according the Union the voting power needed to ensure a real shift in governance structure.\textsuperscript{911} Special shares carrying the right to approve fundamental business decisions are held in an employee co-operative, with employee rights to vote these shares regardless of the amount of shares owned.\textsuperscript{912} Fundamental decisions requiring employee approval include: sale, merger or transfer of the Company; issuance of additional shares that would dilute the equity investment of employees to less than 50%; any major departure from the business plan that is not

\textsuperscript{906} McCartney, supra, note 873 at 246.

\textsuperscript{907} Ibid. at 247.

\textsuperscript{908} Ibid.

\textsuperscript{909} Boniferro, supra, note 875. $2.89 represented a 14.5% decrease for the hourly waged workers.

\textsuperscript{910} Ibid.

\textsuperscript{911} Ibid.

\textsuperscript{912} Series A employee voting shares are held for bargaining unit employees and Series B are held for salaried employees. McCartney, supra, note 873 at 252.
supported by a super-majority of the board; and the purchase of any business or asset outside either the steel business or the communities of Sault Ste. Marie or Wawa.\textsuperscript{913} Given the restructuring of the entire share and governance structure, the parties had to make applications under both the \textit{CCAA} and the \textit{OBCA}.\textsuperscript{914}

The debt restructuring through conversion of debt to shares and debt forgiveness reduced the corporation's annual interest charges from $75 million to $11 million in one year.\textsuperscript{915} The restructuring plan focused on increasing sales by implementing an extensive capital investment programme of $500 million over 5 years, plus $45 million capital investment to meet environmental standards.\textsuperscript{916} Dofasco remained liable for half of the liability in the defined benefit pension plan in exchange for a release from further pension liability.\textsuperscript{917} The Union also secured "infant industry protection" from Dofasco, through a period of agreed non-competition with Algoma accounts and agreement that Dofasco would purchase some Algoma products for a specified period until Algoma was able to develop an independent sales and marketing capacity.\textsuperscript{918} At the sanctioning hearing, the Court noted that the affirmative vote by the six classes of creditors and shareholders demonstrated a very high level of support, indicating overwhelming acceptance by fully informed investors.\textsuperscript{919}

A new thirteen member Board of Directors included five union nominees, the CEO or her or his nominee, and seven independent directors selected by special committee and

\textsuperscript{913} Super-majority defined as eight of the thirteen board members. Boniferro, \textit{supra}, note 875 at 5-6.

\textsuperscript{914} \textit{OBCA}, R.S.O. 1990, c. B-16; McCartney, \textit{supra}, note 873 at 245.

\textsuperscript{915} Quarter, \textit{supra}, note 366 at 126.

\textsuperscript{916} \textit{Ibid.} at 127.

\textsuperscript{917} \textit{Ibid.} at 128.

\textsuperscript{918} Delaney, \textit{supra}, note 365.

\textsuperscript{919} All the votes in support were greater than 95% except for employee classes where the vote was still almost 80% in favour of the plan. \textit{Algoma Steel Corporation v. Royal Bank of Canada (Trustee)} (16 April 1992) [1992] O.J. No. 795, (O.C.J. (Gen. Div.)), Farley J..
acceptable to both to the Union and the Bank debenture holders. Restructuring at the shop floor level took the form of vesting discretionary decision-making with workers instead of supervisors, and reducing levels of supervision accordingly. The express goals were to make production safe, enhance the skills, responsibilities and accountability of workers, and create efficiencies by vesting day to day control of work operations in the hands of worker self-directed teams. A Joint Steering Committee of Union and senior management developed a workplace participation programme to redesign the workplace. Management was to have carriage of discipline, yet there was to be worker/manager co-determination in decisions relating to training, problem solving, cost reduction, and new technology.

Key to these governance changes was that they were incorporated into the Corporate Articles as well as the Collective Agreement. The explicit objectives of the corporation are to undertake decision-making having regard to the goals of economic security, empowerment of workers, improved productivity and quality. This gave formal recognition to the human capital investments of the workers. In turn, when the tough decisions were made about capitalization and dilution of worker shareholdings and closure of the rolling mill plant, there was high buy-in by workers and managers. The Algoma Restructuring Plan expressly recognized that Algoma workers were uniquely

920 Two selected by the national union, two selected by the Local and one elected by the salaried employees, i.e. managers and office employees who are now also unionized by USWA. Boniferro, supra, note 875.

921 Ibid.

922 Ibid.

923 Ibid.


925 The Articles of the Corporation specify that this joint governance will remain in place unless worker share ownership falls below 10%.

926 Memorandum of Agreement between Algoma Steel Inc. and USWA, (20 December 1994), on file with author.

927 Boniferro, supra, note 875.
situated to create value for the corporation's stakeholders. As majority owners and participants in governance of the corporation, the aim was to have workers make the corporation more competitive through greater participation and a less hierarchical workplace.

McCartney points out that the key to the Algoma plan was the same as for most restructurings, a sound business plan that is acceptable to each of the stakeholder groups and that serves as the basis for negotiating a plan of arrangement or compromise. He notes that the challenge was to negotiate both a fair sharing of the "pain" and of the "gain" if the restructuring was to be successful. Co-operation and leadership by the Union, workers and managers, and a willingness to redesign the workplace were key elements in increased productivity and reduction of costs. At the time of the worker buy-out, the value of shares was a few cents per share. In the first two quarters of 1998, shares were trading between $5.00 and $8.00 per share. Although the final quarter reports of 1998 report losses, for the years ended 1993-1998, the corporation reported healthy profits. The turn around may be explained by the combination of a sound business strategy accompanied by governance changes.

C. Recognition of Community as Stakeholder

While there was no formal participation of community stakeholders in terms of the court-directed process, the Algoma Steel case does offer some insight into how community

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928 McCartney, supra, note 873 at 244.
929 Ibid. at 244.
930 Ibid. at 242.
931 Ibid. at 244.
932 Boniferro, supra, note 875.
933 The company has announced closure of one operation, which accounts for its losses and apparently, was projected with the opening of its direct strip operation. Ibid.
interests might be recognized in the restructuring process. Given the enormous impact that the closure would have had on Sault Ste. Marie, the community was very concerned about whether a viable restructuring process could be negotiated. When the Union proposed its alternative plan of arrangement, community interest was formalized by the creation of a non-profit organization called Algoma Community Action Team (CAT).\footnote{Quarter, supra, note 366 at 122-3.} Quarter speculates that the Union's proposal provided a concrete strategy around which community members could mobilize.\footnote{Ibid.} The non-profit organization involved local business and community members. The company, the local government and the union each donated $5,000 to allow CAT to commence its work. Within a short time period, more than 22,000 community residents had taken out memberships, donating $165,000 to help CAT lobby and assist with the restructuring negotiations.\footnote{Ibid.}

CAT did not automatically endorse the Union's proposed plan, although it did come to that conclusion in the fall of 1991. Its significant contribution to the process was that it disseminated information to the public, independent of the corporation and the Union. CAT mobilized the community to pressure governments to support the restructuring.\footnote{Ibid.} Delegations were sent on behalf of the community to meet with both provincial and federal governments, as well as opposition parties. It documented cases of steel plant shutdowns in the United States and used this information to make a compelling case about the economic and social harm caused by firm failure.\footnote{Ibid.} In the Algoma case, CAT never sought formal participation rights. A live issue is whether the Court would have granted such rights had it been asked, perhaps in the nature of intervenor status as I have suggested in chapter 2. CAT's existence and activism, however, created acceptance of the notion that communities can and should have a role in the restructuring process, and are in some circumstances able to organize themselves in such a way as to have their diverse interests represented by one voice.

\footnote{Quarter, supra, note 366 at 122-3.}
\footnote{Ibid.}
\footnote{Ibid.}
\footnote{Ibid.}
\footnote{Ibid.}
D. Lessons for Stakeholder Use of CCAA Processes

There are two lessons that can be usefully drawn from the Algoma experience in terms of corporate governance and effective restructuring processes. The first is with respect to the need to accompany stakeholder participation with governance change in the new corporation. The second is that further thought is needed about the role of government in these workouts.

With respect to the first, clearly not all workout situations are appropriate for worker buy-outs. Businesses that are not potentially viable should not be restructured. However, without the informational capital and participation of workers and their unions in the exercise of determining whether there is a viable plan, these decisions will not be fully informed decisions. Further, insolvency proceedings are one of the few occasions in which workers have an opportunity to acquire governance change. This is because the discounted value of shares affords workers the only opportunity to purchase equity (through investment or wage deferral) in sufficient quantity that they can influence governance change.

Moreover, even if a restructuring plan does not require a worker buy-out, it often does require compromise of workers' claims in terms of workouts of collective agreement obligations.\(^{939}\) It is clear that any such workout further increases the risk of workers losing all of their human capital investment. Thus, in being asked to further invest, workers and their unions, just as other creditors, should be able to extract some governance change as part of the bargain. This may involve seat(s) on the Board of Directors, or changes to the way in which decisions are undertaken in the workplace.

\(^{939}\) Unlike the United States and its very specific treatment of executory contracts, I could find no Canadian case in which the court was asked to order the setting aside of collective agreement provisions. However,
Traditional creditors, particularly secured creditors, have been very effective in ensuring that any compromises worked out in the plan of arrangement includes access to governance change. Usually the board is replaced shortly after the restructuring is complete. Often senior managers are replaced as well, unless their expertise is key to the activities of the restructured enterprise. The reason for this change in managers is that directors and officers may not easily be able to shift their loyalties to creditors or other third parties as the new “owners” of the corporation. The same logic holds true with respect to workers. Given that the old governance structure was premised on a shareholder wealth maximization model, workers lack confidence that existing directors and officers will accord workers and their unions a role in governance. The Algoma case illustrates that negotiations for restructuring and the commitment of human capital investment can give workers and their unions access to governance structures. While workers were initially given access because of their equity investment, the Union was able almost immediately to shift the focus of governance to one which accounts for workers as equitable investors, having regard to both their human capital and equity capital investments. Economic performance has been enhanced by directly involving those with the greatest interest in the viability of the corporation in the governance of the enterprise.

The second issue that is raised by the Algoma Steel case is the role of government in restructuring proceedings. Practitioners point out that often governments quietly assist in restructuring, for example, forgiving various kinds of debt as part of the restructuring strategy. While all creditors must make compromises in the restructuring process, governments must compromise more so in the sense that they have competing public policy objectives of debt collection and encouraging the survival of businesses and preservation of jobs. On the one hand, they wish to collect monies owing through tax instruments, contributions to CPP and Workers’ Compensation, as well as industrial start-up or recapitalization loans. On the other hand, the closure of operations of some

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in Canada, the agreements will be terminated automatically in the event of bankruptcy. This presumably gives workers incentives to negotiate new agreements.

940 Sarra, supra, note 27 at 53.

941 Myers and Sellers, supra, note 870.
companies can have devastating effects for local communities, in terms of decreased local tax bases, lost tax revenues from financial difficulties faced by spin-off economic activities, and increased costs of social supports in terms of employment insurance and welfare assistance. Thus governments will often assist the restructuring process by a certain amount of debt forgiveness accomplished rather quietly. In contrast, in the Algoma Steel case, the Government was entirely up front in its public policy role, encouraging the parties to attempt to fashion a plan that would allow the corporation to survive.

In the Algoma case, stakeholders had different views on the helpfulness of governments. The Union believes that without the Government's intervention, the restructuring would not have occurred. The Government used the incentive of over a hundred million dollars in loan guarantees to help bring parties to the bargaining table. As part of the negotiated restructuring it relieved lenders and preferred shareholders from environmental liability in the event of default and realization of the security, and these environmental waivers facilitated negotiations.\(^\text{942}\) Given that the environmental liability was unknown but estimated to be very substantial, this was a key element. The federal and provincial Governments provided funding for employee training and older workers' adjustments. The Ontario Government adopted a special securities regulation which gave protection to directors and officers against personal liability arising out of future operations, and which gave Algoma and Algoma Finance the status of reporting issuers.\(^\text{943}\) These measures assisted in providing a compromise of creditors' claims, with a view to giving the restructuring plan a chance.

While the issue of how governments should be involved in restructuring needs further thought, clearly governments have a role. Use of public resources to facilitate workouts is not only a productive use of these resources in terms of employment creation or maintenance, but it places governments in a position to extract governance change as part of the terms of the workout. It is not that governments are the optimal arbiters of whether

\(^{942}\) McCartney, supra, note 873 at 247.

\(^{943}\) Ibid.
plans are worthy of support, but rather they can facilitate recognition of stakeholder’s interests as the Government did in *Algoma Steel*. In the *Algoma Steel* case, the Ontario Government supported the Union’s push for worker representation on the board of directors and for a co-determination model of governance. That support, combined with the incentives offered by the Government, were enough to push creditors to consider an alternative model of governance.

In terms of the conceptual framework I proposed in chapter 2, the Algoma case is illustrative of several key components. The Court and all stakeholders recognized the public interest in trying to formulate a restructuring plan acceptable to all stakeholders. It may be that the high dependence of this northern community on a single corporation and the lack of easily transferable skills were part of the reason that the Court recognized that it had a role in facilitating the workout where snags in the process occurred. Second, the plan of arrangement protected creditors and attempted to apportion the compromises among all creditors and other stakeholders. In holding that a determination of whether a plan is reasonable must take into consideration the impact of the plan on all interested parties, the Court signalled that it would take diverse interests into account in its decision making. Third, the plan of arrangement recognized and addressed the need for governance change in order to ensure that the workout was successful. Fourth, stakeholders were accorded participation and decision rights. The equitable interests of workers were ultimately recognized.

Thus the restructuring of Algoma Steel corporation is an excellent example of the importance of recognizing the interests and investments of a broader number of stakeholders in the insolvency debate. It illustrates how my model of governance and restructuring can work in the Canadian context. It has also opened the door for further conceptualization of governance issues during the important period of negotiations under a *CCAA* proceeding. Both the support of the Court and the successful turn around of the Algoma Steel Corporation in terms of governance and wealth creation, has resulted in creditors being less hostile to the more recent attempts by workers and other stakeholders
to actively participate in *CCA* proceedings. As the next chapter illustrates, the result has been even further evolution of recognition of stakeholder claims.

Both Union representatives and managers make reference to no one being entirely in control, and yet both speak of an increasing level of comfort in the joint governance processes in place.\(^{944}\) However, the very nature of the structure means that the workers and Union face another major governance challenge in the next few years. As older workers retire, they can sell their shares on the market or take them out of the trust, which means the Union is no longer able to vote them. After the five year freeze was lifted, workers were able to sell 300 of the three thousand shares they owned, and about one third of the work force took advantage of this. Although this was a minority of workers, this cash-out plus those workers who have subsequently retired has meant a steady decline of the shares held in trust and voted by the Union. Worker ownership as of 1999 rested at 25%. The parties did not originally build in a mechanism to prevent this continual dissolution. Boniferro reports that the Union foresaw the problem, but did not anticipate it would materialize as quickly as it did. Within the next decade, the Union risks losing all its governance measures, according to the minimum worker shareholdings required under the Articles of the Corporation.\(^{945}\) The challenge for the Union is how to maintain the power it has acquired through this co-determination governance structure, while facing a dilution of share ownership. There is a crucial question of whether the governance structure can be maintained without substantial worker share ownership.

Some initial steps have been taken to address this concern. In 1998, the Corporation implemented a mandatory payroll deduction directed toward share purchase, the shares of which continue to be voted by the trust. Similarly, for all new employees, there is a mandatory payroll deduction of $2.00 per hour for three years, directed at share purchase and held in the trust for at least three years.\(^{946}\) These measures are band-aids, but have

\(^{944}\) Pearce, *supra*, note 925; Boniferro, *supra*, note 875.

\(^{945}\) Boniferro, *supra*, note 875.

\(^{946}\) *Ibid.*
slowed the process of loss of worker owned shares until longer-term strategies can be crafted. Bonifero suggests that as the Corporation gets more successful, due in large measure to the governance changes, it will be harder to hold onto worker shares and joint control of the corporation.\textsuperscript{947}

This means that the negotiations for the next Collective Agreement will have an extremely difficult issue to wrestle with. One strategy currently being considered by the Union is to use the gain-sharing plan that was agreed to but not yet implemented, as the strategy by which to allocate capital for the repurchase of shares off the market, shares which would then be voted by the trust. Another is to consider further payroll deductions allocated to share repurchase.\textsuperscript{948} However, any collective agreement that builds in mandatory share purchases will have to be considered not only in terms of concessions the employees will be expected to offer in exchange, but also possible tension from workers about having to "buy the company twice". Whether the Union can negotiate some sort of share allocation that vests the voting shares in the workers of the day, in order to prevent further leakage in shareholdings, is a live question. It is unlikely that governance such as the one that has developed can be sustained without a continued ownership stake. One strategy might be to issue a special class of shares which vests control rights in the Union or the employees of the day. Such a strategy would have to be endorsed as a fundamental change by shareholders, and it is unclear whether it would be successful given the current share structure. During recapitalization, governance changes were safeguarded by the incorporation of participation guarantees in both the Corporate Articles and the Collective Agreement. Thus while there is value in the workers and the union still being involved in governance, if the Corporate Articles no longer entrench these rights, it is doubtful that the Collective Agreement on its own will be sufficient to sustain this governance.

This is not to suggest that the worker buy-out and governance changes at Algoma were purely transitional arrangements. The parties continue to be committed to this

\textsuperscript{947} Ibid.

\textsuperscript{948} Ibid.
governance model. When given the opportunity to cash out 10% of their shares in 1997, more than two thirds of the employees chose to keep all of their shares in the Corporation. This indicates that the majority of workers at Algoma are committed to share ownership and the governance reform that has resulted from recognition of their equity and human capital investments in the firm. The Union considers retention of its co-determination governance structure as its highest bargaining priority and the new provisions for payroll deductions indicate its intention to retain sufficient equity ownership to maintain the governance reforms. What is clear is that the Corporation will have to examine longer-term strategies if it is truly committed to retaining the governance structure in place. The difficulty is that the model does not have a lot of precedents and the parties are crafting strategies for long-term governance as they go along. What does seem evident, however, is that the only means of protecting the governance model is to continue to entrench it in the Corporate Articles.

Most recently, Algoma Steel has suffered from low international steel prices, the weak Canadian dollar, and the dumping of import steel. The corporation, under its joint governance structure, has made the decision to cut some jobs and to create other efficiencies. Steve Boniferro, Vice President of Algoma Steel and a former Union representative has suggested that a co-determination model of governance has helped to ensure greater buy-in by all stakeholders when tough economic decisions need to be made. In 1999, decisions were made to close two facilities, resulting in 600-700 fewer jobs. While the current financial difficulties place pressure on the joint process to act more quickly, which in turn creates some friction, the Union and management have been able to make the tough decisions jointly. That joint decision making process has ensured that harms to workers from restructuring decisions are minimized and retraining and relocation are high corporate priorities. Using retirement incentives, skills upgrading and shifting workers to new jobs created by the opening of the DSPC mill, the number of actual jobs lost was reduced to 240. Rather than allowing workers' human capital to


950 Ibid.
depreciate, comprehensive skills training has accompanied capital investment in new production technologies. Thus protection of workers' human capital investments is at the core of governance decisions. It will be interesting to observe over the next year whether the governance structures in place will stand the corporation in good stead at a time of uncertain markets.
CHAPTER 6

JUDICIAL RECOGNITION OF "SOCIAL STAKEHOLDERS" IN CCAA PROCEEDINGS: ANVIL RANGE MINING CORPORATION

While the social and economic consequences for the community of the closure or restructuring of a business are not of direct concern to the judge in making her or his judicial decisions, they may well affect the court's response to the processing of the reorganization and its approach to the resolution options.

Justice Blair, 1993

The case of Algoma Steel discussed in chapter 5 set the stage for the court's recognition of stakeholders as affected parties in CCAA proceedings. In the Algoma Steel case, the Union had taken a prominent role in negotiations for the restructuring. However, even where employees and other stakeholders do not seek such a prominent role, the courts are moving towards further recognition of their social and economic interests. As is illustrated in this chapter, the significance of the CCAA application of Anvil Range Mining Corporation ["Anvil Range"] is that its employees and their Union were afforded an active role in the CCAA process. This was notwithstanding the fact that their fixed claims for wages and benefits had been satisfied early in the process. Thus, the Court recognized that their interest in the possible restructuring of the corporation was greater than merely the fixed claims that they would have as traditional creditors. While the case

951 Mr. Justice Blair, supra, note 806 at 768-9.

952 In the Matter of Anvil Range Mining Corporation and an application under the CCAA, Ontario Court File No. 98-BK-001268, (O.C.J. (Gen. Div.) (Commercial List)).
has ultimately been converted to a liquidation process in the context of a *CCAA* proceeding, nevertheless, the Court’s findings have important implications for my earlier proposals with respect to how courts should approach the interests of non-traditional investors.

Recent cases brought under insolvency proceedings indicate that the courts are slowly moving towards a more textured understanding of their role in reorganization proceedings. In applying the conceptual framework set out in chapter 2, what is significant for these developments is the recognition by the courts of the diverse nature of stakeholder claims. That recognition has a process component, that of ensuring that parties with an interest in the insolvent corporation are afforded party status and the opportunity to participate in the development of a plan of compromise or arrangement. As is discussed below, it also has a substantive component in that when the Court was faced with a motion to sell residual assets, it declined to make the order notwithstanding the support of 90% of creditors, because of the social and economic consequences of the sale on the community.

Express consideration of the substantive interests of workers and the community is a departure from the traditional role of the court, although there is ample judicial support for plans of arrangement which benefit all stakeholders. For example, in *Elan Corp. v. Comiskey*, the Court held that debtor companies are entitled to a broad and liberal interpretation of the legislation because a resolution under the *CCAA* can have significant benefits for the company, its shareholders and its employees.953

In *Anvil Range Mining Corporation*, the Court expressly recognized the role of what it called the “social stakeholders”. Anvil Range owned and operated a zinc mine called Faro Mine. The Yukon Mine, like many Canadian mines, suffered from intense global competition and low zinc prices. It began to encounter serious financial difficulty and applied for protection under the *CCAA* in 1998. The mine itself had previously been the
subject of another *CCA* proceeding when it was owned by Curragh Inc. Anvil Range bought the Faro Mine from the Interim Receiver of Curragh. At the time of filing the 1998 *CCA* application, the corporation not only economically supported the local community, but its economic activity generated 20% of the Gross Domestic Product of the Yukon.\(^{954}\)

Anvil Range applied for protection from its creditors under the *CCA* in 1998.\(^{955}\) Mr. Justice Farley of the Commercial List granted the initial stay order on January 16, 1998.\(^{956}\) Further stays were granted until February 18, 1998 and then to March 25, 1998.\(^{957}\) Given the importance of the mine’s operation to the territorial economy, the governments were very involved in trying to bring stakeholders together to establish an acceptable restructuring plan. For example, the Yukon Territorial Government (YTG) hosted a number of meetings and consulted broadly with stakeholders with a view to mediating a restructuring proposal and in order to ensure fairness and inclusiveness in the process.\(^{958}\)

The efforts seemed doomed, it was argued, because the Company had missed an important opportunity by failing to consult with key stakeholders during the initial stay period.\(^{959}\) The non-financial stakeholders were defined as the United Steelworkers of America, the Union representing the mineworkers (“USWA”); the former employees of Anvil Range after the mine stopped operations; the residents of the towns of Ross River.

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\(^{953}\) *Elan Corporation, supra*, note 458 at 297.

\(^{954}\) *Anvil Range, supra*, note 953, Oral Submissions, Counsel for Yukon Territorial Government, Fred Myers, August 1998.

\(^{955}\) Arthur Andersen Inc. was appointed Monitor of the Company.


\(^{957}\) *Ibid. Stay Orders* (11 February 1998) and 18 February 1998), Farley J.

\(^{958}\) *Ibid. Supplementary Factum of the Yukon Territorial Government*, (9 April 1998) at 2.

and Faro; and the Ross River Dena First Nation. The stakeholders also included all levels of government and regulatory authorities.

In the Curragh CCAA proceeding, the Court had recognized a First Nation as a party for the first time in a commercial restructuring matter. The Court held that the Ross River Dena Nation was an "affected party" within the meaning of the CCAA proceedings. While it declined to hear the Nation's argument regarding treaty rights and the right to mine, it did order that it would hear from it as a party affected by the restructuring. It directed the court-appointed interim receiver to request any proposed purchaser to negotiate in good faith a social and economic benefits agreement that was reasonably satisfactory to the Ross River Dena Council. In the CCAA application of the successor corporation, Anvil Range, the Ross River Dena Nation was accorded participation and decision rights in the negotiations for restructuring.

A. Concurrent Restructuring and Receivership Proceedings

One of the most positive aspects of the CCAA is its flexibility as a restructuring tool. One of the reasons why there are not accurate statistics available about the number of CCAA proceedings is that these proceedings often deal with multiple issues and the court has been unable to easily categorize them. The flexibility of the statutory language means that the court is able to convert applications from the CCAA into receivership proceedings, or to engage in simultaneous processes under the supervision of the court.

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962 Ibid.
In the Anvil Range case, when a number of creditors determined that the Company’s proposed plan was not feasible, they supported the motion to appoint the Interim Receiver.\textsuperscript{64} The Court adjourned this motion on April 21, 1998 to allow Anvil Range and stakeholders time to explore whether a last minute proposal by the Corporation concerning restructuring addressed the needs of various stakeholders for an early reopening of the mine.\textsuperscript{65} The Union was an active participant in these negotiations as were all three levels of government.

The significance of according the Union status as stakeholder is that employees’ wages and severance had been paid out, and thus the workers and the Union had no fixed claims to be satisfied.\textsuperscript{66} Yet the Yukon Territorial Government and the Court recognized that the workers and their Union had an interest in the outcome of any proposed restructuring.\textsuperscript{67}

The Yukon Territorial Government expressly stated that its objective was to have a process that ensured a fair, open and inclusive process.\textsuperscript{68} The parties participated in meetings with the debtor corporation and stakeholders to discuss the feasibility of a plan of arrangement or compromise. The Yukon Territorial Government tried to facilitate an amended restructuring process with the objective of ensuring the protection of Faro Mine as an ongoing undertaking. Its efforts were aimed at ensuring that no one interest dominated the formulation of a plan, thus playing a mediating and facilitating role. It also sought to achieve environmental protection through a co-ordinated long-term

\textsuperscript{63} June Fraser, Registrar, Ontario Superior Court of Justice, Commercial List, interview (17 January 1999).

\textsuperscript{64} Anvil Range, supra, note 952, Factum of the Yukon Energy Corporation (20 April 1998).

\textsuperscript{65} Supplementary Factum of the Yukon Territorial Government, supra, note 953.

\textsuperscript{66} Michael Kainer, telephone interview (7 May 1998)

\textsuperscript{67} Paula Turtle, Legal Services, USWA, telephone interview, (29 October 1998). There were some interesting alliances. For example, the Yukon government supported the Union’s push to have outstanding wages and severance paid out early in the process.
environmental protection plan. The Government's position was also that the interests of stakeholders, including the Faro mineworkers, were to be taken into account consistent with other objectives of the restructuring process.

By April 1998, the Monitor advised the Court in its capacity as an officer of the Court that the Corporation's current management had lost the support and confidence of most of the major stakeholders, and that continuation of the CCAA process was futile unless an interim CEO with the support and co-operation of the key stakeholders was appointed and parties were willing to play a more co-operative role. Similarly, the Yukon Territorial Government, while advocating an early re-opening of the mine, concluded that Anvil Range was hopelessly insolvent and that there had been no real progress in the restructuring effort in the 90 days since the initial stay order. Despite spending over a million dollars of stakeholders' money since the corporation sought the Court's protection, it had not been successful in advancing a detailed plan acceptable to creditors, nor had it any proposal which might have allowed the re-opening of the mine. Thus, the debtor company had been unable to garner the support of the stakeholders.

The Yukon Territorial Government advocated a public process instead of one involving private parties, in order to ensure that the public economic and social interests of Yukon residents were met. It therefore supported the appointment of an interim receiver at the same time as allowing a parallel continuation of the CCAA process. Given that it

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968 Supplementary Factum of the Yukon Territorial Government, supra, note 953 at 2.

969 Ibid. Yet it was consistent in its submission that any sale should be a competitive bid process.

970 Ibid. at page 2.


972 Supplementary Factum, Yukon Territorial Government, supra, note 957 at 3.

973 Ibid.

974 Ibid. at 8.

975 Ibid.
was in the interests of all the stakeholders to keep open the possibility of a negotiated restructuring, no one objected to these parallel processes, although one could argue that once an Interim Receiver is appointed, the CCAA has been converted into receivership proceedings. Whether technically possible to continue the two processes simultaneously, it is evident that the parties understood that it was open to interested parties who wished to fund the development of a CCAA plan to do so.

The Court appointed an Interim Receiver over all property, assets and undertakings of Anvil Range. 976 The appointment of an Interim Receiver did not necessarily mean a permanent end to the mine operations. Part of the Interim Receiver's duty was to facilitate a transfer of the Faro Mine to a new operator in a manner that takes account of interests of all the stakeholders. 977 In the Anvil Range case, this included the Yukon Territorial Government (YTG) and the Union that had represented the workers when the Mine was in operation. While the YTG was also a creditor, its fixed capital claims were considerably less than the principal stakeholders were, the YTG representing less than 10% of the aggregate amount of secured claims. 978 The YTG made it clear to the Court that it continued to represent the interests of residents on environmental and economic development matters. 979 Similarly, the unionized workers would normally be fixed claimants in terms of preferred and unsecured claims as discussed in chapter 3. In this case, however, the fixed claims of outstanding wages had been paid and the Union represented workers' interest in the long-term viability of the corporation.

976 This included being appointed Interim Receiver over Anvil Range's subsidiaries Anvil Range Mining Property Inc. and Pelly River Mines Limited. The Interim Receiver was Deloitte and Touche. ibid.

977 Factum Yukon Territorial Government, supra, note 959 at 10.

978 Oral submissions of James Grout for certain lien claimants, supra, note 953.

979 Factum, supra, note 959 at 10.
B. The Court's Express Recognition of "Social Stakeholders" and the Balancing of Traditional Creditor Interests

In August 1998, the Court in deciding a motion in the Anvil Range case, expressly recognized the interests of "social stakeholders". Its significance is that it represented recognition that stakeholder interests and resultant participation rights do not directly have to attach to fixed capital claims.

In accordance with a July 29, 1998 order of the Court, in August 1998 the Interim Receiver of Anvil Range had filed its fourth report with the Court. The report suggested that it was unlikely that Faro Mine would re-open within the following two to three years and possibly as long as five years. Based on that analysis, the Interim Receiver recommended to the Court the sale of additional assets that it referred to as the "residual equipment". This equipment, which included mine shovels, drills and other related equipment, were assets without which the mine could not become operational again.\(^{980}\) The Interim Receiver's recommendation was supported by virtually all of the creditors except the Yukon Territorial Government.

In making their submissions on the motion, the Interim Receiver and the majority of creditors argued that the Court should accord considerable weight to the recommendations made by the officer of the Court. They submitted that the economic reality was that the mine would not re-open in the foreseeable future, and that some of the residual mining assets ought to be sold to satisfy creditors' claims.\(^{981}\) They suggested

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\(^{980}\) Anvil Range, supra, note 953, Endorsement (20 August 1998), Blair J., at 2.

\(^{981}\) Grout, supra, note 978.
that if the mine were ever to open again, the company could purchase new assets. Their argument was that while all the creditors have an interest in the mine being in production, given current world prices and exchange rates, it was better to sell the assets on a piece meal basis to any interested party and thus recover some value. Over 90% of the secured creditors supported the asset sale. In exercising its discretion to order the sale of additional assets, the Court was asked to balance the likelihood of the mine reopening with the need to satisfy creditors, the daily deterioration of equipment, and the costs of the Receiver to secure the equipment. The secured creditors argued that they were business people analyzing the prospect of a reopening from a business perspective, that the statute was fundamentally a creditor process, and that it was not for the court to inject its views into the process.

The Union argued that the Interim Receiver did not have expertise with respect to projections of world zinc markets and exchange rates, and that as a result, the Court should not give its usual deference to the report of its officer. The Union had no evidence to the contrary, but argued that the Interim Receiver was engaged in a highly speculative exercise, and that the economic implications of a further sale of assets had potentially very grave consequences. The Union acknowledged that there was only a slim chance of the mine reopening. However, given the enormous economic impact on the workers and the communities, the GDP of the Yukon, and the limited recovery that the sale would effect for the creditors, it submitted that the Court should not order the sale. Replacement of the equipment would be very expensive, essentially guaranteeing that the mine would never reopen. It argued that it was premature to sell the assets required for long-term production, that the Interim Receiver needed to develop a new mine plan, and that absent that plan, the Court should not order the asset sale.

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982 Anvil Range, supra, note 953.

983 Ibid.

Similarly, the Yukon Territorial Government argued that it was not appropriate to require a sale where there was no marketing plan for the enterprise before the Court.\textsuperscript{986} It asked for the motion to be adjourned in order to allow the YTG to conduct further analysis on the underlying assumptions of the Interim Receiver's Report, and on the underlying reports of Strathcona Mineral Services on which the recommendation was based. The YTG had only recently been given a copy of this report.\textsuperscript{987} It submitted that the sale was premature and that the price paid would literally be to forfeit the ability of the mine to reopen.\textsuperscript{988}

The creditors only hoped to realize approximately $1.6 million out of a total debt of approximately $40 million, or 4 cents on the dollar.\textsuperscript{989} Yet for this limited return, the YTG argued, assets essential to the mine's reopening were to be sold. It suggested that for equipment such as shovels and drills, the resale price would not differ significantly over the next few years and thus should not be sold, adversely affecting the prospect of the mine reopening.\textsuperscript{990} Any repurchase of the equipment that was proposed be sold would likely be double plus 15%. The YTG also argued that absent a mine plan, any proposed sale was speculative and should be delayed; that the Court should have before it a cogent effect analysis on the proposed sale of equipment, as well as the mine plan and better information on projected zinc markets internationally.\textsuperscript{991} Both the YTG and the Union pointed out that the mine would only be profitable during windows of high zinc

\textsuperscript{985} Ibid. Any asset sale would have been done on a piece meal basis, shipped to mining and related operations.

\textsuperscript{986} Ibid. Oral Submissions to the Court, Fred Myers, Counsel for Yukon Territorial Government, August 1998.

\textsuperscript{987} Ibid., Interim Receiver's Report, (14 August 1998).

\textsuperscript{988} Myers, \textit{ibid.}; Kainer, \textit{supra}, note 984.

\textsuperscript{989} Interim receiver, figures given orally to the Court, hearing on motion for sale of assets, September, 1998.

\textsuperscript{990} Ibid.

\textsuperscript{991} Myers, \textit{supra}, note 986. He pointed out that the prior sale of the mine was for $25 million plus an equity injection of an additional $30 million.
prices, that the mine had at best 3-5 years of production left, and that it needed to be able to become productive very quickly for high prices, to maximize revenue over a short period of time and then close. Thus, the equipment had to be in place to respond to these expected market changes, and its sale would foreclose the opportunity of having these last years of production and employment. Further, the Government argued that there was no evidence of prejudice to the creditors put before the Court if the sale were to be delayed for a period of time pending development of a mine plan.992

In a judgment dated August 20, 1998, Justice Blair refused to allow the sale of further assets of Anvil Range. The judgment is significant in that perhaps for the first time, the Court allowed a role for what it called the “social stakeholders” which was substantive rather than just procedural. The Court recognized that all the secured creditors and virtually all of the creditors supported the sale of the additional assets. The Court noted that “those with an ‘economic’ interest in the assets favour their immediate sale”.993 It found that the Union and the YTG were “social stakeholders” representing workers and the Yukon public generally, based on a concern about jobs and the general public interest.994 The Court found that it was difficult to be optimistic about the mine’s future prospects and acknowledged that the “social stakeholders” had conceded that the chances of the mine reopening in the near future were slim.995 Any delay in the Court’s approval meant that the assets would not be sold until the following spring.996 The Court also noted that the expert report by Strathcona concluded that the Mine’s best chance for recovery would be if the mine was kept on stand-by mode and made operative quickly if

992 Ibid. The mine would become economically viable only if there was a significant increase in zinc and lead prices combined with a more favourable exchange rate. Affidavit of G. L. Manual (24 March 1999).

993 Endorsement, supra, note 980 at 2.

994 Ibid. at 2. The Faro Mine represented 20% of the economy of the Yukon.

995 Ibid. at 2.

996 As a result of the early freeze-up in the Yukon, ibid. at 3.
market prices went up. To make it operational, it would require the equipment that was proposed to be sold.

The Court held that it must always consider with great deference and weight the opinion and recommendations of its appointed officer, the receiver. Creditors are entitled to pursue their remedies; yet that entitlement is not entirely unrestricted, particularly where the secured creditor has sought a court-appointed receiver. However, Justice Blair held that the court in its supervisory capacity has a broader mandate, holding that:

The Court in its supervisory capacity has a broader mandate. In a receivership such as this one, which works well into the social and economic fabric of a territory, that mandate must encompass having an eye for the social consequences of the receivership too. These interests cannot override the lawful interests of secured creditors ultimately, but they can and must be weighed in the balance as the process works its way through.

The Court balanced the needs of the creditors with those of the social stakeholders. It found that the cash which was likely to be generated by the sale, less than $1 million on over $30 million in claims, was not a large portion of the debt, particularly when the evidence suggested that there was not likely to be a material change in the value of the equipment if it was not sold that season. The Court further held that the interest saving on less than $1 million over one year was not “too great a price to pay to preserve the social and political spirit of those who wish to see the Mine re-open if at all possible”. Consequently, the Court adjourned the sale motion for several months, allowing the YTG to undertake its analysis.

997 Ibid. at 4.
998 Ibid. at 4.
999 Ibid.
1000 Ibid.
1001 Ibid. at 5.
The August 1998 judgment was significant in that it represents a clear message from the Court that it will consider the social and economic consequences of a particular decision. In this, the endorsement represents another step in the evolution of judicial thinking, in which more nebulous notions of "public interest" are being clarified as various stakeholder groups seek participation rights. It also reinforces my statement at the outset of this chapter that social and economic consequences may affect the Court’s response to both the CCAA process and to options for resolution. Creditors are entitled to pursue their remedies, but where they seek the intervention of the Court, the quid pro quo of the court’s assistance is that creditors may have enforcement their interests delayed in the overall balancing of competing interests.1002

It is also significant in that it is the first recognition of "social stakeholders" and the legitimacy of their interests in undertaking the balancing required in CCAA applications. The judgment supports my assertion in chapter 2 that the restructuring process should take account of investments beyond quantifiable fixed capital claims. It also reflects my suggestion that stakeholders affected by firm failure should have both participation and decision rights in the negotiation for plans of arrangement and for decisions which may affect that process. While the outcome of negotiations for restructuring at Anvil Range was unsuccessful, this does not detract from my fundamental claim that these stakeholders have valuable contributions to make in determining whether a viable restructuring plan can be crafted.

While I support the Court’s acknowledgement of stakeholder interests beyond pure fixed capital claims, I have concern about the distinction between economic and social stakeholders. The judgment refers to the creditors as those with an "economic interest" and the laid off employees and the Yukon Territorial government as "social stakeholders". Yet the interests of workers and governments are economic as well as

1002 Myers and Graham, supra, note 953 at 6. Interestingly, it was neither the YTG nor the Union that coined the phrase "social stakeholders" but rather, it was counsel for one of the creditors who used the term and sought to diminish any weight that the Court might give to the role of those stakeholders at the hearing.
social. While in this case, the distinction did not diminish what the Court sought to accomplish, i.e. recognition of broader stakeholder interests, it could create problems in future cases. By failing to recognize that the interests of workers are as a result of their economic interest in terms of their human capital investments, the Court leaves itself open to creditors' arguments that such stakeholders should have seriously reduced participation and decision rights. Having made that observation, the Anvil Range decision represents an important evolution in the Court's thinking. Use of the term "social stakeholder" was an attempt by the Court to distinguish debt, i.e. the fixed capital claims of creditors, from other kinds of interests such as human capital investment and the investments of local governments and communities. As discussed in chapter 2, there is a compelling argument that participation and decision rights should be expanded to broader numbers of stakeholders, particularly workers, given the nature of investments they have at risk in the insolvent corporation. The Anvil Range builds on Algoma Steel in terms of recognizing such interests.

The Court has subsequently acknowledged the importance of considering the interests of social stakeholders in several cases. The filing of a CCAA application by Skydome Corporation and its affiliated companies in November 1998 was precipitated by increased competition in the entertainment industry, declining attendance at Toronto Blue Jays Baseball games and non-payment of approximately $3.6 million in municipal taxes. Skydome employed over 1200 full and part-time employees, generated an estimate $326 million in revenues for the greater Toronto area, and generated $45 million in Ontario Sales Tax. The Court cited the Anvil Range judgment and in particular the passage which recognized the court's mandate to consider the interests of social as well as economic stakeholders. The Court held that while the interests of Blue Jays fans were


1004 Ibid.

1005 Ibid. at 4.

1006 Ibid.
not quite the "social and economic fabric of the region", their interests could not be ignored and the economic ramifications of a failed Skydome for the tourist and entertainment industry were important factors for the Court to consider.\textsuperscript{1007}

More recently, the Ontario Court in \textit{Enterprise Capital Management} adopted the reasoning in \textit{Anvil Range} and \textit{Skydome Corporation} in respect of considering the social and economic consequences and broader public dimension.\textsuperscript{1008} The Alberta Court of Appeal has held that the spirit of the \textit{CCAA} contemplates an attempt at restructuring for the general benefit of all stakeholders.\textsuperscript{1009} There the Court endorsed the lower court decision refusing to sanction a proposed plan because it was not aimed for the general benefit of stakeholders.\textsuperscript{1010} Moreover, in a recent decision of the British Columbia Supreme Court, the Court endorsed the importance of social stakeholder concerns in the \textit{CCAA} process. The court held that the community protected under \textit{CCAA} orders is greater than shareholders and creditors and encompasses suppliers, employees, municipalities and the broader community affected by the well being of the company.\textsuperscript{1011}

The \textit{Anvil Range} case also illustrates the seriousness with which parties to insolvency proceedings are concerned about their environmental liability. This is particularly the case with resource related industries which pose particular issues of environmental protection. In the \textit{Anvil Range} case, the parties ensured that environmental protection was being undertaken with funds derived from assets subject to the secured interests of the creditors.\textsuperscript{1012} Environmental protection measures included pumping to prevent

\begin{footnotes}
\item[1007] \textit{Ibid.} at 5.
\item[1009] \textit{Royal Bank v. Fracmaster Ltd.} (7 June 1999) Alberta Court File No. 99-18326, 27, 31, 35 (Alta. C.A.) at paragraph 36. The Court held that inappropriate use of the legislation would only weaken it as a valuable restructuring statute.
\item[1010] \textit{Ibid.} at paragraph 40.
\item[1011] \textit{Re Starcom} (17 November 1998) (B.C.S.C.), Sanders J.
\end{footnotes}
outflow of the "non-compliant water" from the main pit into a nearby creek and intervention to prevent suspended sediment concentrations from passing through the Sheep Pad Pond in excess of allowable discharge limits.\textsuperscript{1013} The Yukon Territorial Government stressed to the Court that it had a vital interest, on behalf of Yukon residents, in ensuring that the Corporation’s insolvency did not hamper compliance with existing water licenses. What was required was a neutral officer of the court to ensure that the Company met its environmental protection obligations.\textsuperscript{1014} The Court responded by ordering environmental maintenance and coverage of costs of that maintenance.\textsuperscript{1015} It is illustrative of the Court’s balancing of interests and prejudices, including interests beyond those of traditional creditors and shareholders.

One practitioner has observed that the recognition by the Court of social and economic stakeholders in Anvil Range, Skydome and other cases, has set the stage for worker and other interests to be seriously considered by secured creditors and the debtor corporation. This is because they understand that the court will engage in a balancing of the interests of and prejudices to such stakeholders when the matter ultimately comes before the court.\textsuperscript{1016} Since 90% of all matters under CCAA proceedings are resolved through negotiation and settlement, it is this judicial oversight that assists more diverse stakeholders in enlisting the co-operation of parties outside of the courtroom, where the most important discussions for a workout occur.

\textsuperscript{1012} At the point at which the Company filed for protection of the court, there was no equity remaining in the Company for shareholders since the existing liabilities exceeded the corporation’s assets. Anvil Range, supra, note 953, Factum, YTG, (8 April 1998) at 5.

\textsuperscript{1013} Ibid. at 5.

\textsuperscript{1014} Ibid. at 6. The corporation was already in default of requirements of its water license to file annual reports and the YTG argued that it could not be entrusted with the responsibility of environmental protection.

\textsuperscript{1015} Anvil Range, supra, note 953, Endorsement (29 July, 1998) Blair J.

\textsuperscript{1016} Kainer, supra, note 967.
C. *Preserving the Public Interest*

The current status of *Anvil Range* is perhaps the best illustration that local governments and similar stakeholders have a strong interest in the future activities of the corporation. Anvil Range is still under Interim Receivership. The "public interest claimants", as one counsel has called them, are still very involved in ensuring the most beneficial outcome to the proceedings. The YTG and Department of Indian Affairs and Northern Development (DIAND) of the federal government in August 1999 concluded a Memorandum of Understanding that will set up a special purpose vehicle, i.e. a Trust, to ensure that the mine is kept in a state of readiness for production in the event of an increase in world zinc prices. The Trust will also ensure that environmental compliance requirements are met. Cominco Ltd., a major secured creditor, will replace the Interim Receiver, become the site manager and be responsible for the development of an environmental reclamation program and mine plan. In exchange, Cominco acquires some protection from environmental liability and would have first option to operate the mine with a change in zinc prices. The idea is that operating and environmental costs funded by the trust (the trust funds will come from territorial and federal government contributions) will be met by a levy on the mine’s production should it ever be reactivated.

Negotiations are also being held with certain lien claimants to arrange for sale of assets not vital to a start-up, and some of the proceeds of the sale would pay for the reclamation program and fund the initiative to keep the mine in a state of production readiness. While the Union is not directly involved, the governments are keeping it fully apprised of

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1017 Ed Sellers, Counsel for YTG, telephone interview (17 August 1999).

developments.\textsuperscript{1019} The federal government and the Ross River Dena Nation are also trying to determine whether they can enter into a metal recovery process to allow the Nation to recover some of the value of its interests.\textsuperscript{1020} These initiatives illustrate the nature of the interests of government and other stakeholders, their willingness to craft mechanisms to protect such interests, and the importance of allowing participation rights to effect such change. These initiatives have been facilitated by the supervisory role of the Court and its willingness to recognize the equity, debt, human capital and other investments in the corporation.

\textsuperscript{1019} \textit{Ibid.}

\textsuperscript{1020} \textit{Ibid.}
CHAPTER 7

MULTIPLE STAKEHOLDERS WITH DIVERSE INTERESTS:
CANADIAN RED CROSS SOCIETY/ LA SOCIÉTÉ CANADIENNE
DE LA CROIX-ROUGE

When unions as creditors are able to participate on trade creditors committees, they can both benefit their workers and make a contribution to the CCAA process. While there are confidentiality considerations, the increased access to information allows the union to make informed judgments about its claims and allows other creditors to better understand the concerns of the workers and the potential for a mutually acceptable plan.

Michael Kainer 1021

A principal benefit of the remedies available under the CCAA is that the case managed process affords parties in complex cases with multiple interests and multiple claims an opportunity to have their claims heard, resolved or decided in an expeditious manner. It provides a process to ensure the orderly negotiation of a plan of arrangement or compromise where such a plan is viable. An example of the flexibility of the statute as a restructuring tool and of the judicial approach to case management is the CCAA

1021 Michael Kainer, Counsel for the Service Employees International Union in the Red Cross CCAA proceedings, interview (20 July 1999), quoted with permission.
application of the *Canadian Red Cross Society*/*La société Canadienne de la croix-rouge*. ¹⁰²²

As a not-for-profit corporation, the Red Cross had operated a blood donor operation since 1940, and had operated Canada’s National Blood System with funding from federal and provincial governments since 1977. Services of the Red Cross included supply of blood and blood products, disaster relief, homemaker services, and international relief and crisis intervention. The Red Cross employed almost ten thousand people at the time of the *CCA4* filing, many of whom were represented by almost twenty different unions across Canada. ¹⁰²³

In 1998, the Red Cross was experiencing severe financial difficulty as the result of approximately $8 billion in tort claims being asserted against it. ¹⁰²⁴ The tort claims were filed by individuals (the “Transfusion Claimants”) who suffered harm from diseases (HIV and Hepatitis C) contracted as the result of blood contamination. ¹⁰²⁵ There were also cross-claims and third party claims from hospitals and governments. The quantum of the claims for remedy and the cost of defending hundreds of actions would have resulted in the bankruptcy of Red Cross. As a consequence, Red Cross sought and obtained insolvency protection pursuant to the *CCA4*, asking the Court for the opportunity to develop and put forward a plan of compromise or arrangement. It

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¹⁰²² *In the Matter of the Companies’ Creditors Arrangement Act, in the Matter of a Plan of Compromise or Arrangement of the Canadian Red Cross/La société Canadienne de la croix-rouge*, Ontario Court of Justice (Gen. Div.) Commercial List, Court File No. 98-CL-002970, [hereinafter *Red Cross*].


¹⁰²⁴ B. Zarnett, Counsel for applicant Red Cross, in oral submissions to the Court, (19 November 1998) advised the Court that there were 239 outstanding actions against the Red Cross, including 10 certified class actions. The lack of funds to defend these actions was the key reason for the *CCA4* application.

¹⁰²⁵ *Red Cross*, supra, note 1022 (19 August 1998), Blair J.
proposed as part of that process to transfer responsibility for the Canadian Blood Supply to a new national blood authority.  

Although early caselaw was unsettled, recent judicial pronouncements and statutory amendment have now clarified that the term creditor includes tort claimants as contingent creditors within the meaning of insolvency legislation.  

In the case of the Transfusion Claimants, in a report arising out of an inquiry into Canada’s blood system, Mr. Justice Krever had noted that no amount of money would make up for the pain, suffering and premature death caused by the blood related injuries.  

Thus while tort claims are of a contingent nature, here the interests of the Transfusion Claimants had already been established before the Red Cross filed under the CCAA.  

As was discussed in previous chapters, the court’s role is a supervisory one under CCAA proceedings, ensuring compliance with statutory requirements and ensuring a fair and expeditious resolution to issues raised by the corporation’s insolvency. The Red Cross case represents an important illustration of the necessity and efficacy of such a role. While the objective that parties are afforded fair and reasonable opportunity to assess and make their positions known is highly laudable, it is logistically extremely difficult to accomplish when there are multiple parties, different levels of sophistication of the stakeholders, uneven familiarity with processes under the CCAA and before the Ontario Superior Court of Justice Commercial List, vastly inequitable resources available to

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1026 Ibid.

1027 Quebec Steel Products (Industries) Ltd. v. James United Steel Ltd. (1969), 2 O.R. 349 (H.C.); Gnu West Group Ltd. (March 21, 1984), Alberta Queen’s Bench, cited in Tesky, supra, note 151 at 143. Section 2 of BIA, supra, note 5; section 2 of CCAA, supra, note 5. Claims must be “provable” within the meaning of the legislation.


1029 A contingent creditor must establish that it has a provable claim within the meaning of the CCAA and BIA. While the individual claims had yet to be established, the Commission Inquiry clearly established the existence of blood-related claims.
participate in the process, and radically different views as to whether the corporation should survive. The Red Cross case has encompassed all of these elements.

The Court in Red Cross was faced with a difficult balancing of interests. There were numerous trade creditors, employees with pay equity, wage and pension claims, numerous unions representing employees in different provinces, and stakeholders such as the directors of the Red Cross. In addition, there were multiple classes and groups of Transfusion Claimants involving thousands of people and numerous class action civil suits across Canada. The Transfusion Claimants sought an active role in the CCAA proceedings. Moreover, the agencies that were to eventually purchase the blood related assets had identified possible outstanding pension liability issues and were concerned that those issues be addressed. The unions representing the employees and their claims for pension contributions and benefits also sought status to participate in the proceedings. The Court granted Transfusion Claimants, Unions, employees and pensioners status to participate in the proceedings. The Court appointed representative counsel for the Transfusion Claimants, to be funded by the federal and provincial Governments. For the pension litigation, funds for representative counsel came out of monies held in escrow.

1030 Although there was only one secured creditor, other than mortgage and long term leases on equipment. Brian Empey, Counsel for Red Cross, interview (23 June 1999).

1031 The classes included claimants who were singly affected by Hepatitis C (HCV) and those that were doubly affected with HCV and HIV/AIDS. The class actions have been commenced by province or region, by type of class, and by particular periods of time in terms of what testing procedures for contaminants had been available to Red Cross. The precise scope of claims is difficult to determine because the latency period of HCV is 20 years. Motion record, Hepatitis C 1986-90 Class, Red Cross, supra. One estimate suggests that there are 20,000 pre-86, post-90 people alone affected, “Tainted Blood Victims Optimistic as Talks Heat Up”, Toronto Star Newspaper (10 March 1999). There are 10,000 potential claimants in the 1986-1990 period. Bonnie Tough, Class Counsel for the Hemophiliac Action, interview (26 July 1999).

1032 These monies were placed in escrow at the time of the asset sale. In respect of funding for representative counsel, Justice Blair, on approving a motion for additional funding for representative counsel cautioned the parties regarding containing the costs. Red Cross, supra, note 1022.
The order for representative counsel and provision for their fees to be paid eliminated a serious barrier to participation for these stakeholder groups. As noted in chapter 2, the court's practice of ordering financing for creditors committees out of the corporation's residual assets has set the precedent for this kind of funding order. Such orders are even more important for workers and transfusion claimants because the cost of participation would otherwise be prohibitive. If stakeholders are to have meaningful participation and decision rights, then the availability of such court orders becomes an important component in implementing my conceptual approach to restructuring. The reality is, however, that in many CCAA applications, workers and other stakeholders are unaware that they may have participation and decision rights. Often it is only where the debtor corporation has determined that it is in its interests to involve such stakeholders is there a move to involve them and to seek financial assistance to facilitate this participation. Where the interests of the debtor corporation converge at least in part with those interests, it is an important means by which non-traditional creditors acquire participation rights. Such stakeholders should, however, be able to easily seek participation and decision rights even where it is not at the initiative of the debtor corporation. As noted in chapters 5 and 6, active involvement has usually occurred where there are large unions with the information and resources to seek a role in the restructuring process.

The initial order for a stay pursuant to the CCAA in the Red Cross case was made on July 20, 1998.\textsuperscript{1033} It specified that the Red Cross was not disqualified from carrying on the operations of the national blood system pending its transfer to a new national blood agency. Red Cross was also permitted to carry on its non-blood activities in a manner consistent with its objectives and past practices.\textsuperscript{1034} This included raising and dispensing money for the Manitoba Relief Fund to meet the urgent needs of those affected and help

\textsuperscript{1033} Red Cross, supra, note 1022, Initial Order. (20 July 1998), Blair J. at 2. It was initially effective until August 19, 1998. The stay was subsequently extended several times to: October 20, 1998; January 19, 1999; and July 16, 1999. Motion Record of Red Cross (18 January 1999). Red Cross, ibid. (18 January 1999), Blair J..

\textsuperscript{1034} Initial Order, ibid. at 8.
people re-establish dwellings, and its Homemaker Program, providing services to 80,000 Canadians annually.\textsuperscript{1035}

In the initial stay judgment, the Court also ordered the Red Cross to remit to appropriate authorities any statutory deemed trust amounts in favour of the Crown.\textsuperscript{1036} Red Cross was also granted permission to pay legal and monitor fees, outstanding and future wages, employee benefits, pension benefits and other amounts owing to employees, premiums on director, governor and officer liability insurance, and other reasonable expenses to carry on business pending development of the plan of arrangement or compromise.\textsuperscript{1037} Sale of assets was restricted to sales of less than $1 million unless the Red Cross received prior approval of the Court. The Court appointed Ernst & Young Inc. as Monitor to monitor the activities and affairs of Red Cross; to assist Red Cross in the development and implementation of a plan of arrangement or compromise; to assist in the holding and administering of any meetings for voting on the plan; to report to creditors on the financial condition and prospects of the Red Cross as it believed advisable; and to report from time to time as the Court may direct.\textsuperscript{1038} The Monitor was not to manage any of the affairs of the corporation.\textsuperscript{1039} The specificity of the order is typical of the direction given by the court in \textit{CCAA} proceedings, providing flexibility while setting terms and conditions under which the corporation can retain possession of its assets and to continue to operate.\textsuperscript{1040}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{1035}Affidavit of Brian Empey, \textit{Red Cross, supra}, note 1022 at paragraph 16.
\item \textsuperscript{1036}Initial Order, \textit{supra}, note 1033 at 9. These were amounts required to be deducted from employees' wages, including Canada Pension Plan, employment insurance, Quebec Pension Plan, income taxes with respect to employees, and GST payable.
\item \textsuperscript{1037}Ibid. at 9-10.
\item \textsuperscript{1038}Ibid. at 15-16.
\item \textsuperscript{1039}Ibid. at 17-18.
\item \textsuperscript{1040}See however the discussion in chapter 3 regarding the Court's direction to simplify initial orders, \textit{supra}, note 591.
\end{itemize}
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The federal, provincial and territorial governments (FPT Governments), the Red Cross and two blood agencies, Canadian Blood Services/Société Canadienne du Sang (CBS) and Hema-Quebec (H-Q) had worked out the terms of sale of assets in a National Blood Program Acquisition Agreement in which the national blood system would be transferred by Red Cross to CBS and H-Q.\textsuperscript{1041} Red Cross would retain its other activities such as homemaker services and disaster relief. Given that the CBS and H-Q had already negotiated the Acquisition Agreement on July 10, 1998 prior to the initial stay order, the Court also ordered that nothing in its initial stay order would restrain or otherwise affect the rights pursuant to the National Blood Program Acquisition Agreement. The Court directed that pending the granting of an order approving the Acquisition Agreement and the transfer of the blood system, the Red Cross, its agents and employees and the Monitor were directed to co-operate with CBS and H-Q to assist in resolving transitional issues in contemplation of the blood system transfer.\textsuperscript{1042} The order contained the usual "comeback" clause, specifying that there was nothing to prohibit the Red Cross or any interested person from seeking direction of the court on notice. The Court also specified in the initial stay order that pursuant to section 17 of the \textit{CCAA}, it was requesting the assistance of any Canadian court, administrative or regulatory body to "act in aid of and be complementary to this court" in carrying out the terms of the order, deeming the Monitor to be foreign representative of the Red Cross.\textsuperscript{1043} The Red Cross operates both nationally and internationally, and this was to ensure the effectiveness of the stay order in other Canadian jurisdictions.

The challenge of effectively managing complex cases under the \textit{CCAA} and of according substantive and procedural recognition to diverse stakeholder interests is illustrated by several motions that the Court was required to deal with in the restructuring proceedings. These motions illustrate the need to balance the public interest with the claims of various parties to the assets of the corporation. I use examples of four motions as illustration: the

\footnote{1041 \textit{National Blood Program Acquisition Agreement, Red Cross. supra, note 1022, [hereinafter Acquisition Agreement]}.}

\footnote{1042 \textit{Ibid.} at 18.}
adjournment motion brought by the Transfusion Claimants, the motion for approval of the sale of the assets, the Court approved process to resolve pension claims of past and current Red Cross employees, and the proposed restructuring plan itself.

A. Sale of Assets in Advance of Court Approval of a Plan of Arrangement or Compromise - Adjournment to Allow for Meaningful Participation

The Court was asked to deal with a motion to sell the assets of the national blood program pending development of a proposed plan of arrangement or compromise. The proposed sale of the assets arose out of both governmental and public pressure to ensure the safe delivery of blood and blood products across Canada. A Commission of Inquiry had previously examined the blood system in Canada, and Mr. Justice Horace Krever in the Final Report of the Commission recommended the immediate development of a new blood system in order to protect public safety. The proposed new national blood authority consisted of two agencies, Canadian Blood Supply (CBS) providing the national blood program to all of Canada excluding Quebec, and Hema-Quebec (H-Q) providing blood services to Quebec.

The proposal to divest the Red Cross of the national blood program was brought to the Court for approval. As the result of extensive governmental negotiations and deadlines

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1044 *Commission of Inquiry, supra,* note 1028 at 1030, 1044. He also recommended the creation of a no-fault scheme for compensation of blood related injury.

1045 The agencies had agreed to co-ordinate their activities to ensure national coverage of the program. *Motion Record, Red Cross, supra,* note 1022.
on a line of credit, the planned sale was scheduled to take place on September 1, 1998.\textsuperscript{1046} The tight timeframe required expeditious approval of the sale by the Court. Yet the point at which the motion for sale of assets came before the Court, representative counsel for the Transfusion Claimants had only recently been appointed. Representative counsel sought an adjournment of the motion in order to be able to adequately assess the planned sale of the assets. The Court in deciding whether to delay dealing with the proposed sale of assets and transfer of the national blood program, was required to balance multiple interests, those of the creditors, the federal, provincial and territorial governments, and in particular, the public interest in having a continued blood supply.\textsuperscript{1047}

The endorsement represents acknowledgement that what is in the public interest in \textit{CCAA} proceedings is not always apparent. It was clearly in the public interest to "ensure the seamless continuation of the delivery of safe blood products across Canada" and the preservation of the human capital involved in that delivery.\textsuperscript{1048} However, the Court also had to take account of the public and private interest in allowing the Transfusion Claimants as creditors to be meaningfully involved in the process. In rendering its decision, the Court noted that it was one of the most difficult adjournment decisions it had ever made. On the one hand, the Court noted that the continued viability and safety of the blood system was absolutely essential and the failure to proceed created a serious risk of firm failure and loss of the service of key employees.\textsuperscript{1049} On the other hand, to deny the adjournment would result in three classes of Transfusion Claimants being deprived of a reasonable opportunity to assess whether the asset sale would provide a maximization of returns on Red Cross' blood related assets.\textsuperscript{1050}

\textsuperscript{1046} \textit{Red Cross, supra}, note 1022, endorsement (31 July 1998), Blair, J.

\textsuperscript{1047} \textit{Ibid.}

\textsuperscript{1048} \textit{Ibid.}

\textsuperscript{1049} \textit{Ibid.} at 2.

\textsuperscript{1050} \textit{Ibid.}
The Court held that the CCAA process and the process leading up to consideration of approval of the sale of assets must be seen to be fair and reasonable to the Transfusion Claimants whose interests lie at the heart of the process. The Court noted that it had responsibility for supervising the proceeding, for considering the complexities of the issue, and for ensuring that its decision was intelligent, informed and not merely a rubber stamp. The Court held that its ultimate assessment on the fairness and reasonableness of a plan of arrangement might be hindered if there had been a built-in level of real or perceived unfairness to an important group of participants from the outset of the proceedings.

The interests of the Transfusion Claimants, although a contingent interest in the sense of the type and quantum of claims, was nevertheless recognized as a valid interest. The Court held that in most cases a request for adjournment would be granted without hesitation because parties in such proceedings are entitled to a reasonable opportunity to assess and respond to particular proposed actions, not only in their own interests but to assist the Court in arriving at a decision with the benefit of cogent submissions. Here, the Court held that the people whose claims from blood contamination injuries resulted in the CCAA application, and for whose benefit the result of the sale process is aimed at, were left out of the process until after the CCAA proceedings were commenced. As a consequence, the Court granted an adjournment of two weeks to allow representative counsel a reasonable opportunity to assess the proposed asset sale. The Court’s decision represented not only a balancing of the interests and prejudices at that stage of the proceeding, but also sent a message to the debtor corporation that the process must necessarily involve adequate notice and timely disclosure in order to make the participation of the contingent creditors and other stakeholders meaningful.

1051 Ibid.
1052 Ibid.
1053 Ibid.
1054 Ibid.
B. Recognition that Plans of Arrangement Can Be Proposed by a Variety of Stakeholders

When the motion for the sale and transfer of the blood supply assets and operations from Red Cross to CBS and H-Q did come before the Court, some classes of Transfusion Claimants opposed the sale on grounds of the Court’s jurisdiction to order a sale pending the development of a proposed plan, an objection that the Court expeditiously dealt with. The Court found ample authority for its jurisdiction to make an order for the sale and transfer of the blood related assets, both in its power to impose terms and conditions in the granting of a stay under the CCAA and based on its inherent jurisdiction to fill gaps in legislation to give effect to the objectives of the CCAA. Here the parties had complied with the conditions set out in the Initial Stay Order, specifically, that the Red Cross was required to seek court approval of sale of any assets valued at greater than $1 million and had demonstrated to the Court’s satisfaction that the sale and transfer was in the best interests of the corporation as a whole.

One group of Transfusion Claimants objected to the sale and transfer, proposing a plan of arrangement in which the Red Cross would retain control and operation of the national blood system for a period of time. The proposed plan involved the Red Cross converting the system to one of direct cost recovery from hospitals, thus generating revenue from a fee-for-service system and enhancing the pool of money available to satisfy the tort claims. The group proposed a no-fault plan of compensation for all

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1055 Section 11, CCAA. supra, note 5. Red Cross, supra, note 1022, endorsement (19 August 1999), Blair J., citing the Eaton’s restructuring as an example of the Court’s jurisdiction.

1056 Red Cross, ibid., at paragraph 21.

1057 The 1986-90 Quebec HCVclaimants, supported by a group of B.C. pre-1986/post-1990 HCV claimants, ibid. at paragraph 23, 24.
Transfusion Claimants.\textsuperscript{1059} The Claimants asked the Court for an order dismissing the request for approval of the sale and transfer, requesting instead an order directing a meeting of creditors for the purpose of considering and voting on their proposed plan of arrangement. The Court ultimately decided to approve the sale of assets because it found the proposed plan of arrangement unworkable, contrary to the current political exigencies, and prejudicial to the blood system, employees, hospitals and other health care providers.\textsuperscript{1060} The Court thus refused to exercise its discretion to order a meeting of creditors to consider and vote on the proposed plan.\textsuperscript{1061} However, the Court clearly acknowledged the right of contingent creditors to propose their own plan of arrangement.\textsuperscript{1062} This recognition reinforces my claim that stakeholders beyond traditional creditors can, within the current statutory language, make their own restructuring proposals under the \textit{CCAA}. More broadly based recognition of this would encourage other stakeholders to seek participation rights where they can contribute to the development of a viable business plan.

Moreover, in undertaking the balancing of interests and prejudices, Justice Blair examined expert evidence, the assumptions underlying the proposals, the positions of key stakeholders such as the federal, provincial and territorial governments, employees, health care providers and Transfusion Claimants.\textsuperscript{1063} The Court concluded that the value

\textsuperscript{1059} This would be through the creation a compensation fund for victims of tainted blood transfusions, \textit{ibid} at 2.

\textsuperscript{1059} \textit{Ibid} at paragraph 25.

\textsuperscript{1060} \textit{Ibid} at paragraph 34.

\textsuperscript{1061} \textit{Ibid}. Similarly, the Alberta Court of Appeal in \textit{Royal Bank v. Fracmaster Ltd} (7 June 1999) Docket Calgary 99-18326-7, 18331, 18335 (Alta. C.A.) held that while the \textit{CCAA} does permit sale of assets under \textit{CCAA} proceedings, the Court's sanction of such a sale will depend on its conclusion that the proposed transaction is in the best interests of creditors generally, at paragraph 16.

\textsuperscript{1062} \textit{Red Cross}, \textit{ibid}. The Court concluded that there would be delay and confusion to test the proposed plan, with detrimental effects on the blood system, and that over 900 hospitals had not budgeted for a shift to a direct cost recovery system.

\textsuperscript{1063} \textit{Ibid} at paragraph 30.
that would be recovered with the sale, $169 million, was as high as was possible.\textsuperscript{1064} After the debt to the bank was paid and claims of other creditors defrayed, there would still be 70-100 million dollars in a trust fund to satisfy transfusion claims.\textsuperscript{1065} The Court gave full consideration to whether the sale was fair and reasonable in all the circumstances.\textsuperscript{1066} The decision by the Court to allow the timely sale of assets also meant that much of the informational capital and skills of workers was not lost to blood services, because the new Blood Agencies hired virtually all of the 3,230 employees from the transfusion part of Red Cross' operations on the same terms and conditions of employment as the Red Cross.\textsuperscript{1067} Thus the Court engaged in a balancing of the interests at risk and considered the prejudice to all stakeholders affected by the decision.\textsuperscript{1068}

\section*{C. Effective Use of Mediation/Arbitration to Settle the Pension Claims}

In a number of CCAA cases, an important issue has been how to determine claims to and distribution of pension fund surpluses. For most pension plans, the benefit is based on an

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{1064} Ibid. at paragraph 18, 30.
\item \textsuperscript{1065} Ibid. at paragraph 18.
\item \textsuperscript{1066} The Court in \textit{Red Cross} applied the tests set out in \textit{Soundair Corporation v. Royal Bank of Canada} (1991), 7 C.B.R. (3d) 1 (Ont. C.A.) at 6, specifically, was a sufficient effort made to get the best price and the actions were not improvident; was it in the best interests of all parties; was there efficacy and integrity in the process; and was there any unfairness in working out the proposal. The Court concluded based on these considerations that the price was as close to the maximum as is reasonably likely to be obtained for such assets. \textit{Ibid.} at paragraphs 16, 18.
\item \textsuperscript{1067} Ibid. at paragraph 18, 19. Andre Picard, "New Blood Agency Stresses Accountability", Toronto Globe and Mail (29 September 1998) at A3.
\item \textsuperscript{1068} This reasoning was subsequently adopted in Fracmaster where the Court endorsed the Court's decision in \textit{Red Cross} and held that in CCAA applications the objective was to facilitate restructuring and to consider the interests beyond those of senior creditors. \textit{Re Fracmaster Ltd.}, (17 May 1999), Docket Calgary 9901-05042, (Alberta Court of Queen's Bench), Paperny, J., affirmed Alberta Court of Appeal, \textit{supra}, note 720, at paragraphs 18-23.
\end{enumerate}
\end{footnotesize}
estimate of future earnings and payout experience. If the assets earn more than predicted or (more rarely) the payout costs are less than predicted, then a surplus results. The Supreme Court of Canada has held that surplus in an ongoing plan does not belong to anyone, but an employer can take a contribution "holiday" if the language of the plan permits, and if the actuary concludes that the contributions are not required.1069 Second, a pension trust is irrevocable and the surplus belongs to the beneficiaries, unless the trust specifically allocates the surplus to the employer or there is a sufficiently broad power of amendment in the trust documents to permit the employer to amend the trust document to revoke that part of the trust that is surplus.1070 It is usually ambiguity in the language of the trust document combined with differing provincial legislation concerning the process for obtaining the surplus that results in uncertainty of ownership and claims to the surplus. When a corporation reaches insolvency, these issues come to the fore because the pension surplus may be viewed by the debtor corporation and creditors as a possible source of funds to satisfy claims.

In the Red Cross case, development of a plan of arrangement was not possible without first ascertaining what amount of money might be available to satisfy the claims of various stakeholders, including workers and pension beneficiaries in terms of the pension surplus. The Acquisition Agreement endorsed by the Court, which transferred the national blood supply, included provision for a protocol to settle outstanding pension claims. The Agreement provided that after its execution, the Red Cross would give notification to all unions representing employees who are now or have ever been members or beneficiaries of Red Cross' pension plan; and notice to all non-unionized employees and interested individuals.1071 Red Cross and the new blood agencies were then to enter into discussions with unions and others regarding disclosure of potential pension claims and design of a process to resolve them. The issues involved potential liability of the Red Cross and CBS and H-Q in relation to potential pension claims;


1070 Ibid.

1071 Including pensioners, spouses, former spouses, and any former employees who retained a pension entitlement.
disposition of the debtor corporation's pension plan assets and liabilities; transfer of pension plan assets and/or establishment of new pension plans by the new blood agencies or the Red Cross. The Acquisition Agreement included an order for a holdback of $32 million to be placed in escrow pending resolution of the pension liability issues.\(^{1072}\) The Court gave the parties 60 days to resolve how to proceed with the pension claims or to return to the Court for direction.\(^{1073}\)

The sale and transfer of assets closed on September 28, 1998 and $32 million of the proceeds went into escrow in accordance with the Acquisition Agreement.\(^{1074}\) The parties subsequently negotiated and then received Court approval in November 1998 for a procedure to resolve the outstanding pension liability issues.\(^{1075}\) The procedure involved broad notice through a variety of means, and then a mediation process in which the Court appointed the Honourable Lloyd Houlden, a retired justice of the Ontario Court of Appeal, to mediate a settlement.\(^{1076}\) The stakeholders had agreed to make their best efforts to settle outstanding disputes. The issues that the parties were to resolve included contribution issues of whether the Red Cross was entitled to pay administrative and investment expenses from the pension fund; whether liability for pensions had transferred to the new blood agencies in terms of money owing or obligation to continue with this or another plan; and the amount of money to be directed out of the escrow fund to satisfy pension claims.\(^{1077}\) Failing successful mediation, the parties agreed to litigate the matter before an arbitrator who would interpret the relevant collective agreements and

\(^{1072}\) This was at the initiative of the purchasers who identified this potential liability prior to the sale. Empey, supra, note 1030.

\(^{1073}\) Red Cross, supra, note 1022, Endorsement (21 August 1998), Blair, J..

\(^{1074}\) There were two escrow funds in addition to the one earmarked for pension claims; $36 million for real property adjustments and $10 million earmarked to deal with residual transfer issues. Red Cross, supra, note 1022, Affidavit of Robert Rae, (15 January 1999), Chief Negotiator for Red Cross in Government negotiations for settlement of tort claims.

\(^{1075}\) Red Cross, supra, note 1022, Order (6 November 1998), Blair, J..

\(^{1076}\) Red Cross, ibid., Notice of Motion, Procedure of Potential Pension Claims, at paragraph 3.

\(^{1077}\) Ibid.
legislation across Canada. The procedure was aimed at full and final resolution of the pension issues, in lieu of grievance or other labour arbitration, any process before any statutory pension regulatory agency in Canada, or any civil action. Any mediated or arbitrated resolution also required the approval of the Court.

The protocol provided for additional funding for representative counsel out of the amount in escrow. The twenty unions as well as the non-union employees and former employees were represented by four representative counsel in the mediation/arbitration process. The pension plan was registered in Ontario but subject to the statutory requirements of pension legislation in other provinces across Canada. Thus, the Court concluded that this procedure could not bind the parties in terms of their right to argue that the minimum statutory standards had not been met in these jurisdictions. Given the number and complexity of claims by numerous unions involving many jurisdictions, the unions and workers wanted a practical and expeditious resolution to the pension issues. This was particularly so because of the number of pensioners dependant on expeditious resolution of the issues.

Mediation was conducted over three days and final approval negotiated over several months. This matter, while still pending in August 1999, is in the process of being finally resolved and will likely come before the Court for approval in the near future. If the matters are ultimately resolved, the workers with only pension claims will no longer be eligible to participate in the vote for the proposed plan of arrangement, given that their fixed claims will have been satisfied.

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1078 Ibid.
1079 Ibid.
1080 Ibid.
1081 Red Cross, supra, note 1022, Oral submissions of Union Representative Counsel, (9 November 1998).
1082 Red Cross Proposed Plan of Arrangement, supra, note 1022.
The Court had also approved one of the representative counsel of the Transfusion Claimants to represent their interests in the pension-related mediation. That counsel did not have authority to bind the various classes or groups of Transfusion Claimants, but the aim was to ensure that Transfusion Claimants were kept advised on the process, and to reduce administrative and court costs in the mediation and negotiation process. The involvement of the Transfusion Claimants in the pension dispute resolution process was novel in that they had no more direct claim in the pension dispute that a traditional creditor and would normally not be involved in resolution of such claims. However, practically speaking, approval of a plan of arrangement will not be possible without these creditors because their claims exceed the assets of the corporation. Moreover, the plan’s development was contingent on resolving the pension liability issues because this would determine the pool of assets available for a plan of arrangement. Thus, recognition by the debtor corporation and the Court of the need to involve the Transfusion Claimants early in the process was recognition of the importance of an expanded approach to participation and decision rights. Given the Court’s earlier comments on the need to ensure the fairness of the process before it reaches the court for final sanctioning, the participation of Transfusion Claimants in the pension dispute resolution process was consistent with the Court’s approach in the case.

The parties also used ADR techniques in other parts of the CCAA proceedings. For example, there was a $47 million pay equity claim by the Service Employees International Union (SEIU), filed as part of the claims procedure. The Red Cross previously had been required to negotiate and post a pay equity plan pursuant to pay equity legislation. At that time, in making representations for funding to the Ontario Government, the Red Cross had advised the Government that it required approximately $47 million to make the required pay equity adjustments. At some point prior to filing the CCAA application, the Red Cross had set aside $15 million in trust transferred

1084 Red Cross, supra, note 1022, Motion Record, Service Employees International Union, (28 July 1999).
from the provincial government to satisfy pay equity claims. When the corporation was subsequently financially distressed, it hired a consultant to revise the pay equity plan, resulting in a conclusion by the Red Cross that it owed considerably less in pay equity adjustments. Thus there was a dispute between the SEIU and the Red Cross regarding the amount of the pay equity claims. During the workout proceedings, the Red Cross and the SEIU negotiated a settlement of the claims in the amount of $10.2 million in lump sum payment to workers covered by the pay equity plan. Approval of the settlement is to come before the Court in September 1999, and if approved, the claims will no longer fall within the class of unsecured creditors for purposes of voting on the proposed plan of arrangement.

There are two interesting observations about the process to resolve the pay equity claims. First, the claims represented a sizeable portion of the unsecured claims in the proceedings and the Red Cross needed to devise a means by which the amounts owing could be resolved. The use of negotiations as an alternative to litigation was key in resolving the claims amount and in allowing the Red Cross to move the CCAA proceedings forward. Although parties are not able to contract out of the statutory standards of remedial employment legislation, here the actual pay equity standard to be met was in dispute and the settlement was aimed at providing a resolution to that dispute, thus allowing the corporation to progress in its preparation of the plan of arrangement. The settlement of the claims will allow the workers to immediately receive pay equity

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1085 Kainer, supra, note 1021.
1086 Ibid., Motion Record of Red Cross (28 July 1999).
1087 Although the monies were in trust, some of the Transfusion Claimants objected to the settlement. In order to avoid the court having to determine the matter, the Red Cross agreed to adjourn approval of the amounts for several weeks in order to allow the parties to meet and resolve any outstanding issues with respect to the pay equity money in trust. Kainer, supra, note 1021.
1088 Part of the settlement involved negotiating a new collective agreement with Red Cross, including recognition rights for several new sites. Ibid.
adjustments, while still ensuring that the Red Cross has met its obligations under the Pay Equity Act.\textsuperscript{1089}

Second, because the claims were unsecured, the Court endorsed having an SEIU on the trade creditors' committee. Michael Kainer points out that such participation is key to gaining access to information for unions. Although membership on the creditors' committee carried with it certain legal obligations and confidentiality requirements, the Union nevertheless was able to better monitor the corporation's activities during the workout process. Representation on the creditors' committee allowed the Union to make more informed decisions on behalf of its members with respect to its potential support for the restructuring plan.\textsuperscript{1090} Equally important was the informal exchange of views and ideas that such participation allowed. Given that the settlement of matters in CCAA proceedings occurs primarily outside of the court room, the exposure to other creditors and ability to exchange views is key to assisting traditional creditors better understand the claims of workers, including their willingness to compromise and to help devise workable plans of arrangement or compromise.\textsuperscript{1091}

\textbf{D. The Proposed Plan of Arrangement}

The Red Cross sought and obtained several extensions of the stay period during 1998 and 1999. The reason was that the Red Cross had not finalized settlement of the pension issues, and because the federal, provincial and territorial governments had entered into

\textsuperscript{1089} The Union has the authority to bind the employees in terms of the final pay equity plan. Only in very limited circumstances would employees have the right to challenge the agreement of the Red Cross and the Union. However, there is no indication that this will occur in the Red Cross case. See for example, \textit{Group of Employees v. Parry Sound District General Hospital and Ontario Public Service Employees Union, Local 320} [1995] 13 O.P.E.D. 1.

\textsuperscript{1090} Kainer, supra, note 1021.

\textsuperscript{1091} \textit{Ibid.}
negotiations with the Transfusion Claimants regarding compensation. As part of one extension granted, the Red Cross was to file a proposed plan of arrangement or compromise by March 29, 1999. In considering whether to exercise its discretion to extend the stay, the Court expressly recognized that the negotiations between the governments and the Transfusion Claimants would have a significant impact on the formulation of the plan and the approach of the claimants to it. The Court attributed the progress of negotiations for restructuring to the "Herculean" efforts of all of the stakeholders and commended the parties. The Court also granted extended time for the stay period, aimed at avoiding the necessity and cost of Red Cross having to return to the Court for extension of shorter stay periods. This flexibility by the Court coupled with firm case management, ensured that the CCAA proceedings were working toward an optimal outcome in restructuring negotiations.

In balancing the interests and prejudices involved during formulation of the plan, the Court also lifted the stay to allow approximately fifteen transfusion-related lawsuits to proceed. The Court held that there were compelling reasons that these proceedings should be allowed to proceed, including the fact that a number of claimants had a reduced life expectancy. The Court dismissed another motion, however, in which former

1092 The parties negotiated a Framework Agreement with representatives of federal, provincial and territorial governments and representatives of the 1986-90 HCV claimants as the basis for negotiations of the availability of compensation from the government. Affidavit of Robert Rae, Chief Negotiator for the Red Cross, (15 January 1999).

1093 Ibid. This date was initially February 26, 1999 and then was revised.

1094 Red Cross, supra, note 1022, Endorsement (18 January 1999), Blair, J.. The Court found that the statutory requirements had been met.

1095 Ibid.

1096 Ibid.

1097 Empey, supra, note 1030. In part, this was because the costs of defense proceedings were to be borne by the insurer and thus would not come from the assets available to satisfy the claims of transfusion claimants and other stakeholders. In the balancing of prejudices, the Court allowed these actions to proceed.

1098 The Red Cross did not oppose this lifting of the stay for this purpose. R. Bragg, "Suits Against Red Cross Get Go Ahead", Toronto Globe and Mail (26 April 1999).
management employees sought a lift of the stay to determine a related-employer issue. The Court held that there was nothing to take these particular claimants out of the CCAA claims process that it had sanctioned to provide a streamlined approach to the resolution of claims. The stay was aimed at giving Red Cross a "respite from litigation" and the Court must engage in a balancing of prejudices. Here, it concluded that the matter should be dealt with in the CCAA claims process. The Court's determination of both these motions illustrates further the balancing that the Court undertakes, engaging notions of public interest by examining the specific prejudice to parties in any given decision.

The Red Cross filed its proposed plan of arrangement with the Court on March 29, 1999. On May 5, 1999, the Court approved the Red Cross' request to convene meetings with its creditors to consider and approve the plan; an order establishing a claims procedure for the Transfusion Claimants; setting a claims submission date and deadline for receipt by the Monitor of proof of claim for purposes of voting on the proposed plan of arrangement. Provision was made for extensive notice through mail, newspaper ads and electronic means, an information hotline, and through representative counsel and a number of agencies advocating on behalf of transfusion recipients.

The Monitor was directed to provide to each person claiming an information package with forms and instructions on how to complete and submit the forms. It was to prepare a list of Transfusion Claimants for the sole purpose of determining eligibility to

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1099 Red Cross, supra, note 1022, Endorsement (26 April 1999), Blair, J., at 6.

1000 Ibid.

101 The proposal defines transfusion claimant broadly to include any claim arising at any time directly or indirectly as a result of the receipt of blood collected or supplied by the Red Cross prior to September 28, 1998. Red Cross Proposed Plan ofArrangement, dated March 29, 1999.

102 The newspaper ads appeared across Canada on June 23, 1999. See for example, Toronto Globe and Mail (23 June 1999).

103 Notice to Persons Who May Have Transfusion Claims Against the Canadian Red Cross Society, June 23, 1999, Toronto Globe and Mail Newspaper (23 June 1999).
vote on the proposed plan of arrangement. The Monitor was to review the responses after the claims submission date of July 30, 1999 and ask the Claims Officer to resolve any dispute with respect to a claim. The Red Cross was then to conduct meetings with creditors to consider, and if advisable, pass a resolution to approve the Plan.

The express purpose of the Proposed Plan of Arrangement is to effect an arrangement with Transfusion Claimants and “Ordinary Creditors”, to enable the Red Cross to continue its national and international humanitarian service for the “greater benefit of all persons with an interest in the society or who rely on its assistance”. The Proposed Plan sets out three elements of reorganization. First, subject to approval by creditors and the Court, the Red Cross will pay $60 million into a Transfusion Claimant Trust and the Trust will provide a mechanism to establish the quantum of claims and the distribution of funds to various Transfusion Claimants. Second, on the Plan Implementation Date, the Plan of Arrangement provides for payment of all Ordinary Creditors. Third, the Red Cross will carry on its current charitable and humanitarian activities.

For Ordinary Creditors with proven claims against Red Cross of $50,000 or less (or greater claims but who have chosen to be treated as if their claims are $50,000), their claims will be fully satisfied. For creditors with proven claims against the Red Cross

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104 The proposed plan specifies that the Monitor is not to use this confidential medical information for any purpose other than to determine voting eligibility under the CCAA. The court order includes a direction that the confidentiality of medical information of the Transfusion Claimants be maintained. Red Cross Proposed Plan of Arrangement, supra, note 1022.

105 The meetings were to be held in September 1999, but have been rescheduled to January 2000. Red Cross, supra, note 1022, Motion Record (28 July 1999).

106 Red Cross Proposed Plan of Arrangement, supra, note 1022 at 1. Ordinary creditors included all claims that were not transfusion related claims.

107 Ibid. at Article 2.

108 Ibid.

109 Ibid. at Article 3. Even if a creditor has elected to be valued less for payment, its vote will be the aggregate amount of the proven value of the claim for purposes of voting on the proposed plan.
of greater than $50,000 (who have not elected to be in the first group), 75% of their claims will be paid within 30 days of the Plan Implementation Date.\textsuperscript{1110}

The Proposed Plan also provides that while Red Cross desires that those with blood-related injuries be assisted, it does not make an admission of liability. The Plan refers to the Settlement Agreement between the Federal, Provincial and Territorial (FPT) Governments in terms of settlement of the 1986-1990 Class Actions. The intention of the FPT Settlement Agreement is for the Governments to pay up to $1.1 billion to approximately 10,000 persons infected, directly or indirectly, with the Hepatitis C virus as the result of blood or blood products received from January 1, 1986 to July 1, 1990.\textsuperscript{1111} If ultimately endorsed by both the claimants and the courts, the agreement will be full and final settlement of all 1986-1990 class actions and a number of individual actions. The fund will be distributed on the basis of the severity of illness and loss as set out in the FPT Settlement Agreement.\textsuperscript{1112}

The FPT Settlement Agreement envisions a disability scheme that recognizes that the Transfusion Claimants have suffered or may in the future suffer a variety of negative health effects. Thus, rather than provide the Transfusion Claimants with a one-time cash settlement, it is tailored to pay compensation as each person’s circumstances evolve in the future.\textsuperscript{1113} A number of the traditional onuses of proof in civil proceedings have been reversed in the claims adjudication process, thereby hopefully reducing the transaction costs in the processing of claims.\textsuperscript{1114} An independent trustee, called the Administrator, will manage the fund. Protocols are currently being negotiated by the

\textsuperscript{1110} Ibid.

\textsuperscript{1111} Ibid. at paragraph 5, as well as interest dating back to April 1, 1998.

\textsuperscript{1112} Red Cross Notice, supra, note 1022.

\textsuperscript{1113} Class Counsel Statement to Announce Details of Hepatitis C January 1, 1986 to July 1, 1990 Class Actions Settlement, (15 June 1999) at 1, cited to class action web site, www.hepc8690.com [hereinafter Class Action Settlement].

\textsuperscript{1114} Tough, supra, note 1031.
Administrator and a Joint Committee of four Class Action Representative Counsel in terms of how claims are to be adjudicated.\textsuperscript{1115} This includes a notification and testing process, a claims process, initial claims determination by the Administrator, use of an ombudsperson to mediate disputes, and a mediation and arbitration procedure for appeal of claims.\textsuperscript{1116} Given that there is not a readily identifiable respondent to monitor the activities of the Administrator, the Administrator will be a court-appointed official.\textsuperscript{1117} The Joint Committee will give advice and direction and undertaking some monitoring, not unlike a creditors’ committee in a \textit{CCA} proceeding, although general oversight will be the responsibility of the court.\textsuperscript{1118}

Although the FPT Settlement Agreement is not final and is subject to court approval, it was tabled before the courts in the Ontario, British Columbia and Quebec class-action proceedings and a public notice campaign has been sanctioned by the courts seized with those matters.\textsuperscript{1119} Hearings will be held in these three provinces in August 1999 to decide whether to approve the settlement, based on whether the settlement is fair, reasonable and in the best interests of class members.\textsuperscript{1120} If the settlement is approved,

\begin{itemize}
    \item If the claims are for less than $10,000, the claimant must appeal through the mediation/arbitration procedure. If the disputed claim is $10,000 or greater, the claimant has the option of using the referee procedure under the Rules of Civil Procedure, in which the referee makes a report to the court and the claimant has all the normal rights of appeal. A claims centre has been set up in Ottawa, Ontario. \textit{Ibid.}
    \item The Red Cross is not funding the settlements and the FPT governments do not want to be responsible for administration of the plan, thus the parties required some creativity in crafting accountability mechanisms for administration of the Settlement. \textit{Ibid.}
    \item The Joint Committee will have authority to approve matters on a unanimous basis and failing unanimity or on major issues, the Administrator will seek advice and approval from the court. The Fund will also be reviewed every three years to ensure that it is being properly administered. \textit{Ibid.}
    \item \textit{Ibid.}
\end{itemize}
claimants will begin to receive payment commencing in January 2000.\textsuperscript{1121} If endorsed, it will represent the largest personal injury settlement in Canadian history.\textsuperscript{1122}

The Proposed Plan of Arrangement under the *CCA A* proceedings is in large measure dependent on the successful approval of the FPT Settlement Agreement. If the FPT Settlement Agreement is implemented, the Transfusion Claimants claiming under that process will be deemed to have assigned the benefit of their rights and interests to the FPT Governments who in turn will have the right to vote for the Proposed Plan of Arrangement for the Red Cross.\textsuperscript{1123} Moreover, the funds available for satisfying claims under the *CCA A* plan will be aimed at those Transfusion Claimants who are not eligible for compensation under the FPT Settlement Agreement.

For purposes of voting on the *CCA A* Proposed Plan of Arrangement, the plan proposes two classes of voting creditors. The first class of “Ordinary Creditors” is comprised of all creditors other than the Transfusion Claimants.\textsuperscript{1124} They are to vote based on the value of their claim, with one vote for every dollar of their claim. The second class includes all the Transfusion Claimants, who for purposes of voting on the Proposed Plan are to be given one vote per person, i.e. a value of one dollar per claim (not a vote attached to the alleged value of their tort claim). The Proposed Plan will be approved if the majority in number of each class, representing 2/3 the value of proven claims, vote in favour of the Plan.\textsuperscript{1125} Court endorsement and implementation of the plan would then represent full and binding treatment of the claims. If the Plan is implemented, the Transfusion

\textsuperscript{1121} Hearings are scheduled in Ontario, British Columbia and Quebec for August 18 and 23, 1999. *Ibid.* The original payout date was scheduled for the fall of 1999 but has been revised because of the requirement of a notification and testing period. Tough, *supra*, note 1031.

\textsuperscript{1122} Tough, *ibid.*

\textsuperscript{1123} They will not, however, have access to any funds from the trust being created by the Red Cross for the remaining Transfusion Claimants. Similarly, insurers are not entitled to receive a distribution from the Trust. *Ibid.* at Article 5.04.

\textsuperscript{1124} The claims of secured creditors were satisfied by the asset sale or are in the process of being satisfied and thus there are no outstanding secured creditor claims. Empey, *supra*, note 1030.

\textsuperscript{1125} *Red Cross Proposed Plan of Arrangement*, *supra*, note 1022 at Article 5.
Claimants will have claims only against the Trust, and the Trust will assume full responsibility for resolving the transfusion claims and administering the costs of doing so.\textsuperscript{1126} The Proposed Plan of Arrangement specifies that rights are preserved except against the Red Cross, present and former officers, governors and employees.\textsuperscript{1127}

The assignment of one dollar per Transfusion Claimant for the limited purposes of voting on a proposed plan of arrangement is a novel means of trying to grant the Transfusion Claimants voting rights on the proposed plan without first having to spend considerable resources to quantify the value of their claims. There are precedents for this approach in the United States, although none of the cases to date have actually been decided on whether the courts have jurisdiction to do this. In the \textit{Red Cross} case, the issue of whether the \textit{CCAA} allows for such an allocation of value for voting purposes has yet to be decided. Given that the claims procedure under the \textit{CCAA} makes reference to that specified under the \textit{BIA}, if there is a dispute about the jurisdiction of the court to value claims at one dollar for purposes of voting on the Proposed Plan, recourse might be had to those provisions. Under the \textit{BIA}, the Trustee makes the decision as to the value of the claim where the value "is not admitted" by the corporation. Arguably, this authority may assist in finding jurisdiction for the Court to value the Transfusion Claims for the limited purpose of voting on the Proposed Plan.\textsuperscript{1128} From the perspective of the Transfusion Claimants, the U.S. experience has indicated that the valuation of claims is a very costly exercise that ultimately depletes the value of assets available to satisfy claims. Thus it may make more sense to accept the Red Cross' proposal for purposes of voting on the Proposed Plan of Arrangement, particularly since it does not affect the value of claims that can be asserted either in the plan's claims process or in civil proceedings if they ultimately continue. Where this voting scheme may not be acceptable is for those HIV

\textsuperscript{1126} \textit{Ibid.} at Article 5.06.

\textsuperscript{1127} \textit{Ibid.} at Article 5.08.

\textsuperscript{1128} See for example: Section 12(2), 12(3), \textit{CCAA, supra}, note 5; Section 54, 124, 135, 160, \textit{BIA, supra}, note 5.
claims that have already been judicially determined, and thus who may insist that the value of their claims for voting purposes has already been established. 1129

Even if the one vote per one Transfusion Claimant is endorsed, there is some question as to whether the Proposed Plan of Arrangement can ultimately receive the requisite amount of support. There are an estimated 20,000 pre-1986 claims and 1,000 post-1990 claims that have not yet had the benefit of a settlement with the federal, provincial and territorial governments. 1130 There are potentially 10,000 1986-1990 claimants covered by the FPT Settlement Agreement. Even if the Governments acquire the rights of all those claimants, there is a live question as to how many claimants will file under the CCAA proceedings and thus what number from what group would carry the vote. 1131 Assuming that only a fraction of people will file claims in time for the CCAA claims voting process, it may be that the assignment of votes by the 1986-1990 claimants will be sufficient for the FPT governments to carry the class vote.

The Court Order specifying the establishment of the claims procedure for voting purposes in respect of the Transfusion Claimants was without prejudice to the right of any party to contest the manner in which creditors’ claims have been valued or divided into classes. 1132 This matter may yet come before the Court for determination and if so, may be key to setting some guidelines as to how equitable investors can participate in CCAA proceedings without the costly prerequisite of having the value of their claims precisely determined.

1129 Tough, supra, note 1031.
1130 Ibid, citing the epidemiological studies in the tort actions.
1131 The deadline for registering a claim for purposes of voting on the CCAA plan was July 30, 1999, however, the Monitor has undertaken to bring any late filed claims back to the court, given the information barriers and the number of incorrectly filed claims. Oral Submissions of the Monitor in the Red Cross proceedings (28 July 1999).
1132 This would have been possible under the “come back” provisions of the Court’s order in any event.
E. Lessons for Stakeholder Participation

The existence of multiple stakeholders with diverse claims illustrates both the flexibility of the CCAA process and some of its current limitations. The Red Cross case is the first in Canada to have tort claimants involved as key creditors in the CCAA process. The case highlights that the nature of claims and the ability of the corporation to workout its affairs may depend on whether creditors, including non-traditional creditors, have any interest in the turnaround of the finances of the corporation. For the contingent claimants, the liability of the corporation arises from its past actions. Given the nature of the harm incurred, it is likely that such claimants are not supportive of having the corporation survive. Thus, absent some incentive to vote in favour of a plan of arrangement, such as receipt of damages over the liquidation value of their claims, it is unlikely that tort claimants will support a plan. Generally, contingent creditors are likely to support a plan if some compromise of their claims today provides greater realization on their claims in the future. However, for health related claims, time may be of the essence. Where there is the possibility of third party payment of the claims, as has been the case in Red Cross, the CCAA process can be used as bargaining leverage for extracting a better settlement. While this is vitally important for the contingent creditors, it can also work to derail the negotiations for a viable restructuring plan for the debtor corporation.

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1133 Tough, supra, note 1031.

1134 A good example is the settlement of the 1986-1990 claims, in which the availability of third party funds may result in support for the proposed plan of arrangement from these claims. For the other groups, there is a live question as to whether any additional monies with be forthcoming that would provide inducement to support the proposed plan. For example, the insurers of the Red Cross appear not to have contributed any funds to a potential settlement of claims, yet if the plan fails and the tort cases proceed, the insurers will be liable for both the court costs and any settlement or court ordered payments.
In contrast, the workers with pay equity and pension claims have not only an equitable investment in the corporation in the nature of a reliance interest as discussed in chapter 2, but they and the unions that represent them have a strong interest in the future survival of the corporation. Thus there is a divergence of interest with those of the contingent creditors. Similarly, trade creditors have interests in both the past and future activities of the corporation. Yet, as the law is currently constructed, these parties all have the same rights to vote on a proposed plan. Thus a debtor corporation in negotiating a workout under the CCAA, will have to ensure that the different interests of these stakeholders are met, or it is unlikely to garner sufficient support to have the plan endorsed. As discussed above, this has been one of the central challenges of the Red Cross case.

The second issue raised by Red Cross is the importance of early disclosure so that the parties can assess their positions and where possible mediate a resolution. In Red Cross, the creation of a central data room aided the representative counsel in reducing information asymmetries and controlling transaction costs in trying to individually acquire information. In turn, this facilitated their participation in the proceedings. Similarly, the ad hoc committee of the Transfusion Claimants' counsel allowed for a sharing of information and a division of tasks early in the process, as well as allowing counsel a forum to attempt to reach consensus on a number of issues. Moreover, the support of insolvency counsel allowed the Representative Counsel to co-ordinate the various legal proceedings between the courts seized with the tort actions and the CCAA proceedings. In turn, this eliminated some of the transaction costs for the debtor corporation by helping to avoid unnecessary return to the Court to amend orders rendered out of date by other proceedings.

However, the case also illustrates some of the ongoing problems of information asymmetries highlighted in chapter 2. For example, the Union representing the pay equity claimants only discovered by accident that $15 million had been set aside in trust

\[1135\] Ibid.

\[1136\] Ibid. Tough suggests that this is key to effective participation of contingent creditors.
for settlement of pay equity claims.\textsuperscript{1137} Although the corporation had disclosed this to the Court in the boxes of documents, it did not advise the Union of the existence of this trust, notwithstanding its $47 million dollar claim.\textsuperscript{1138} Given the volume of information involved in such cases, it raises a legitimate question of how much and in what form a debtor corporation is required to disclose its assets to creditors and other stakeholders. The objective is to find the optimal balance of providing disclosure sufficient to allow parties to consider their positions on an informed basis, versus the cost of providing that information.

Third, the \textit{Red Cross} case illustrates the importance of good insolvency counsel who are able to craft creative strategies to deal with complex and novel situations. Here the debtor corporation attempted to devise a number of mediation, arbitration and other negotiation strategies in order to resolve as many outstanding disputes as possible prior to seeking approval of its proposed plan of arrangement. It sought to involve multiple interests at various stages of the proceeding, in order to minimize issues that would come before the Court. Moreover, it utilized the flexibility of the process to ensure that the \textit{CCAA} proceedings moved in tandem with the class actions and other proceedings, in order to control transaction costs as much as possible and to ensure the \textit{CCAA} proceedings were moving forward. The Court's understanding of the importance of this co-ordination and its flexibility in terms of decisions regarding the lifting of stays, extension of stays and sorting out the relationships between the parties, has been key to success of the process to date.

The \textit{Red Cross} case, although still before the Court, illustrates how effective the current \textit{CCAA} regime can be in balancing the interests of numerous stakeholders with diverse claims. The ultimate success of the Proposed Plan of Arrangement, if the Red Cross is

\textsuperscript{1137} This discovered by the Union while sitting in court one day, flipping through a number of financial documents. Kainer, \textit{supra}, note 1021.
successful in garnering stakeholder support and the endorsement of the Court, will provide an excellent example of the creativity of the parties and the flexibility of the Court. They will have successfully balanced numerous “public interests” and given full recognition to the equity, debt and equitable investments of stakeholders.
CHAPTER 8

*MED-CHEM HEALTH CARE LIMITED/
SOINS DE SANTÉ MED-CHEM LIMITÉE:
LIMITS OF THE CURRENT REGIME*

The Union was a very constructive participant on the Restructuring Committee of Med-Chem, working hard to find the compromises that would allow the corporation to restructure. In the end, without the support of secured creditors and flexibility in the process, such efforts are unlikely to be successful.

Lloyd Houlden
Chair Med-Chem Restructuring Committee

The previous three chapters have illustrated that in cases such as Algoma Steel, Anvil Range and Red Cross the Court has been highly effective in recognizing the diverse interests of non-traditional creditors and other stakeholders, while at the same time respecting the necessity and importance of traditional creditor interests. I observed in chapter 3 that the notion of public interest is really a short form for the complex balancing of interests in which the court engages in undertaking decision making in insolvency proceedings. The recent proceeding of *Med-Chem Health Care Limited/Soins de santé Med-Chem limitée* ("Med-Chem") illustrates that an effective understanding and

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1139 Honourable Lloyd Houlden, Former Justice, Ontario Court of Appeal, interview (27 July 1999), quoted with permission.
balancing of the interests at risk is somewhat dependent on the way in which the issues are framed for the court.\textsuperscript{1140}

In \textit{Med-Chem}, the Ontario Superior Court of Justice granted the Union participation rights in the \textit{CCAA} process including membership on the restructuring committee. This was an important recognition of the interest of the workers in the future of the insolvent firm. However, \textit{Med-Chem}'s \textit{CCAA} application was then converted to a receivership and bankruptcy proceeding. At the point that the Receiver was considering and then recommending the sale of the assets, the notion of workers as equitable investors was not part of the equation. The Union involved asked the Court to exercise its discretion not to approve the sale and to direct the Receiver to consider a late bid that was comparable in value but which preserved 450 jobs. The Union was unsuccessful.

For purposes of my thesis, \textit{Med-Chem} highlights some weakness in the court's process. In previous chapters I have argued that the insolvency system should be characterized by an objective of enterprise wealth maximization and recognition of the diverse interests of all those with debt, equity capital, human capital and other investments in the corporation. While the Court in \textit{Med-Chem} engaged in this balancing at the outset of the process, the short period in which the Court ordered an end to the \textit{CCAA} proceedings failed to achieve an optimal balance between effective case management and flexibility in allowing parties sufficient time to determine whether they could reach consensus on a proposed plan. Second, at the point of the bankruptcy sale, the court's concern for the integrity of the sale process (an important concern) outweighed concern for a process that engages in a balancing of interests as described above. As a result, we do not know what the Court's decision would have been if it had engaged in a balancing of diverse interests. Judicial oversight may require clearer direction to the court's appointed officers to ensure that this balancing of interests is engaged before the issue comes before the Court in a motion to approve a sale.

Med-Chem was a medical laboratory operation and included a group of related companies. It was the third largest medical laboratory in Ontario, serving approximately 2,300 physicians through more than five hundred collection and delivery sites throughout Ontario. Med-Chem operated a large central laboratory, nine satellite laboratory facilities, forty-three licensed specimen collection centres and more than a hundred unlicensed specimen collection centres. The business operations that it carried out also included 50% to 100% interests in five other medical laboratories in Ontario. Approximately 95% of its revenues were derived from the Ontario Health Insurance Plan (OHIP) payments, and thus one of the corporation's most valuable assets was its corporate billing cap (Corporate Cap) established by the Ontario Ministry of Health.

At the time of the CCAA application, Med-Chem employed 890 full and part-time employees. 78% of these employees, over 700 workers in total, were unionized and represented by the Brewery, General and Professional Workers' Union (the "Union").

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1141 The related companies were Scarborough Laboratory Services Ltd., Vaughan Medical Laboratories Ltd., and Astra Laboratory Services Limited, joint ventures with Med-Chem. Med-Chem was responsible for managing the day-to-day operations and business affairs of these companies. *Med-Chem Fourth Report of the Receiver PricewaterhouseCoopers Inc., in its capacity as Receiver and Trustee in Bankruptcy* (14 April 1999) [hereinafter *Fourth Report of Receiver*] at paragraph 23. The corporation also had other business interests that were not part of the eventual asset sale including Diagnostic Veterinary Services and Lab Arts Institute, both wholly-owned by Med-Chem, assets in the United States, and a 50% interest in MCTU, the largest Ontario provider of diagnostic services. MCTU was not part of the Receivership order. *Med-Chem, Second Report of the Receiver* (5 March 1999) at paragraph 58.

1142 *Med-Chem, supra*, note 1140, *Factum of PricewaterhouseCoopers Inc.* (12 April 1999) at 3 [hereinafter *Factum of Receiver*]. The activities were carried out either by Med-Chem or related subsidiaries.


A. The CCAA Proceedings

Med-Chem experienced financial distress as the result of expansion in the mid-1990's, acquisition of significant long-term debt and inability to service that debt in 1997-8. It attempted a private workout with creditors and when that failed, it applied and received the stay protection of the Court under CCAA proceedings in December 1998.\(^{1146}\)

A Restructuring Committee was struck, which included secured and unsecured creditors, including the president of the local union as a preferred and unsecured creditor. The mandate of the Restructuring Committee was to provide advice and assistance to Med-Chem with respect to solicitation and evaluation of offers to purchase the corporation's assets.\(^{1147}\) Thus from the outset, the parties anticipated new equity ownership as the principal restructuring mechanism and outcome. There were numerous interested parties, in part, because the Corporate Cap guaranteed a particular amount of business income and because within weeks of the CCAA application and replacement of senior managers, the corporation started operating at a profit.\(^{1148}\) PricewaterhouseCoopers Inc. was the court-appointed Monitor under the CCAA application.\(^{1149}\) Unlike many CCAA applications in which the Monitor facilitates negotiations for a workout, in Med-Chem the Monitor essentially observed and was not part of the efforts to restructure.\(^{1150}\) On December 30, 1998, Med-Chem filed a plan of compromise and arrangement pursuant to

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\(^{1146}\) By Court Orders (1 December 1998) and (4 December 1998). Ibid. at paragraphs 8-10.

\(^{1147}\) Med-Chem, supra, note 1140, Affidavit of James Cameron Nelson, Motion Record, President Brewery, General and Professional Workers' Union, (13 April 1999) at paragraph 10.

\(^{1148}\) Nelson, interview, supra, note 331. At the time of the filing, the Vice-President of the Union went on the Board of Directors.

\(^{1149}\) Med-Chem, supra, note 1140, Order (4 December 1998), Gans J.

\(^{1150}\) Houlden, supra, note 1139.
the CCAA and the plan was put to the corporation’s creditors. This effort was unsuccessful.

On January 14, 1999, the Restructuring Committee received an offer from Canadian Medical Laboratories Limited ("CML") to purchase the assets of Med-Chem. The offer was conditional on the Union accepting certain terms for its employees. The Union and members of the Restructuring Committee entered into negotiations with CML in order to try to accommodate its concerns and ultimately preserve Med-Chem as a going concern with the continued employment of workers. Based on a representation by CML that it would continue to operate the central laboratory because its own facilities could not handle the additional work of both companies, a series of negotiations then took place in which CML requested and the Union conceded an ever growing list of concessions regarding employment security and contracting out. The Restructuring Committee believed that the business was viable and the Union was prepared to make considerable compromises on its claims to achieve a viable workout, including compromise of benefits and protections that it had previously successfully bargained. The central laboratory employed more than 450 unionized workers and the Union had a strong interest in trying to find an arrangement acceptable to the debtor corporation and

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1151 Third Report of Receiver, supra, note 1140 at paragraph 11.

1152 Ibid. A possible proposed plan of arrangement included a pension fund injecting $15 million in the restructured firm in exchange for a 63% interest and $40 million in new loans from the National Bank of Canada. In the end, this plan failed because the pension fund did not want to acquire controlling interest in the company. The sale of a related company, MCTU Diagnostics would have paid the secured creditors in full, and other creditors would receive cash, five year promissory notes and common stock. L. Zehr, "Med-Chem offered $15 million by equity and investment pension fund. Court hears" Toronto Globe and Mail (5 January 1999) at B1.

1153 Affidavit of Nelson, supra, note 1147 at paragraph 11.

1154 Ibid. at paragraphs 11, 12. At a negotiation meeting in January, 1999, CML’s President/CEO advised the restructuring committee that Med-Chem’s central laboratory was better suited to perform the specimen collection than its own facilities and had the capacity to handle the additional work of both companies, whereas its own lab did not.

1155 Nelson, supra, note 331.

1156 Motion Record, supra, note 1140. Based on these same representations, the Union wrote to CML the day following that meeting, advising it of the accommodations that it would make in order to facilitate restructuring, Letter to John Mill, President of CML (15 January 1999).
the potential purchaser. The Honourable Lloyd Houlden, who chaired the Med-Chem Restructuring Committee, described the efforts of the Union as highly constructive in the restructuring negotiations.\textsuperscript{1157}

Subsequently, CML withdrew the offer that included continuing the operation of Med-Chem's central laboratory, and instead sought yet a new list of concessions from the Union.\textsuperscript{1158} This time they would essentially have destroyed the bargaining unit and eliminated most jobs.\textsuperscript{1159} The newly proposed concessions together with the withdrawal of the offer to continue operating the central laboratory made the proposal unacceptable to the Union. The Union advised the Court that it wished to continue discussions with a view to negotiating a plan acceptable to all creditors. However, CML would not discuss the restructuring any further.\textsuperscript{1160} When the Restructuring Committee sought further bids on January 18, 1999, CML did not bid. Counsel for CML advised the Union president that CML did not want to deal with a unionized workforce and would not discuss these issues with the Union.\textsuperscript{1161}

Subsequently, CML submitted a revised offer to the Restructuring Committee, the terms of which included discharging 450 employees. This was rejected by the Restructuring Committee.\textsuperscript{1162} There was also another interested institutional investor, but unfortunately that pension fund could not move quickly enough to receive internal approval for the $100 million capital injection that Med-Chem required.\textsuperscript{1163} Just less

\textsuperscript{1157} Houlden, supra, note 1139.

\textsuperscript{1158} Affidavit of Nelson, supra, note 1147 at paragraph 14.

\textsuperscript{1159} The Union was convinced that the change in CML's proposal was to avoid operating a unionized main laboratory. Nelson, supra, note 331.

\textsuperscript{1160} Affidavit of Nelson, supra, note 1147 at paragraph 15.

\textsuperscript{1161} Ibid. at paragraph 16. There appears to be no dispute that this exchange took place.

\textsuperscript{1162} Ibid. at paragraph 17.

\textsuperscript{1163} Nelson, supra, note 331.
than two months after granting CCAA protection, the Court would not extend the proceedings further and declared the corporation bankrupt. This represented a much shorter period than usual for a corporation of this size and number of sites to workout its affairs.¹¹⁶⁴

B. The Bankruptcy of Med-Chem

The Court declared the CCAA proceedings terminated on February 1, 1999 and declared Med-Chem bankrupt.¹¹⁶⁵ The Court then appointed the Monitor as Receiver and Manager of all property, assets and undertakings, as well as Trustee in Bankruptcy (collectively referred to as the Receiver).¹¹⁶⁶

The Receiver assumed control of the assets and conducted a sale process.¹¹⁶⁷ As noted in chapter 2, even in bankruptcy proceedings, sale of assets as a package or on a going-concern basis can largely preserve the equitable investments of workers, local suppliers and landlords. Thus the conversion of the process from a CCAA to a bankruptcy proceeding did not in of itself mean that the process would disregard these diverse interests. The Court authorized the Receiver to offer new employment to employees on a temporary basis if the Receiver believed desirable to do so and endorsed the Receiver’s

¹¹⁶⁴ Houlden, supra, note 1139; Tay, supra, note 1140.

¹¹⁶⁵ Med-Chem, supra, note 1140, Order (1 February 1999), Gans J.. The corporation was adjudged bankrupt pursuant to a petition for a receiving order filed by a creditor, naming PwCI as Trustee in Bankruptcy. Third Report of Receiver, supra, note 1140 at paragraph 14.

¹¹⁶⁶ Factum, supra, note 1140 at paragraphs 7, 8.

¹¹⁶⁷ Med-Chem, supra, note 1140, Orders (19 February 1999), (9 March 1999), Gans J.
request for an order that it was not a successor employer.\footnote{Med-Chem, supra, Order (1 February 1999), Gans J. at paragraph 2.} As the result of the "deemed termination" of employees arising from the bankruptcy and receivership, the claims by unionized employees on the estate of Med-Chem for termination pay, wage, sick-pay and vacation arrears amounted to more than ten million dollars.\footnote{Affidavit of Nelson, supra, note 1147 at paragraph 21. There was some dispute about this figure, however all parties agreed that the claims amounted to more than $8 million and that the employees were the largest group of unsecured creditors.} Thus, the unionized workers were the largest group of unsecured creditors.\footnote{Ibid.}

It was in the interests of the Receiver, the workers and the corporation to continue operations pending the sale of assets. The Receiver negotiated and signed an Agreement with the Union (the "Receiver/Union Agreement"), which was approved by the Court in March 1999.\footnote{Agreement between the Receiver and the Union, [hereinafter the Receiver/Union Agreement], (17 February 1999), Med-Chem, supra, note 1140, Order (9 March 1999), Gans J..} The Receiver wanted the Union's agreement not to apply for a declaration that the Receiver was a successor employer because it did not wish to acquire liability as a successor employer during the period that it was conducting the sale process.\footnote{Affidavit of Nelson, supra, note 1147 at paragraph 19.} The Union agreed to this in exchange for the Receiver's agreement to abide by the terms of the Collective Agreement in employing workers through the sale process.

The Receiver/Union agreement set out that the Receiver was offering to retain the services of all active employees and that such employment would be for the duration of time that the Receiver determined necessary.\footnote{Receiver/Union Agreement, supra, note 1171 at 1.} The Receiver agreed to pay $280,000 in outstanding wage arrears owing to employees and agreed to pay almost one million dollars in vacation pay owing for employees that agreed to remain working for the corporation during the sale process period.\footnote{Receiver/Union Agreement, ibid. The Receiver was employing the workers in its capacity of receiver, not of trustee, at 1. Third Report of Receiver, supra, note 1140 at paragraph 22.} The Receiver also paid both arrears
owing and current payments due during the sale process to an insurance company that provided the health plan of the workers.\textsuperscript{1175} The Receiver would not continue funding the employer’s portion of the Defined Contribution Pension Plan, but did agree to increase employees’ wages by 1% in consideration for this.\textsuperscript{1176} The non-unionized employees benefited from these negotiations between the Receiver and the Union, receiving the same arrangements as the unionized workers. The parties agreed that all the other fixed capital claims not paid by the Receiver were unsecured claims against the estate of Med-Chem.

The Receiver also agreed on a without prejudice basis to abide by the Collective Agreement between the Union and Med-Chem, signed November 26, 1996 and amended by a Memorandum of Agreement dated August 17, 1998.\textsuperscript{1177} The Union and the Receiver did not agree on whether the Receiver was bound by the Collective Agreement and the parties agreed to reserve their rights in this respect.\textsuperscript{1178} The aim was to keep operating without prejudicing the parties’ ability to pursue their legal rights. The Collective Agreement contained relatively strong language protecting the workers from unjust dismissal and lay-off due to contracting out.\textsuperscript{1179} The Union believed that in negotiating this Agreement, it was protecting its members. Thus, workers agreed to continue their further human capital investment by continuing to work for the firm instead of searching for new employment.

\textsuperscript{1175} Ibid.

\textsuperscript{1176} Ibid. at paragraph 24.

\textsuperscript{1177} Including “the grievance and arbitration provisions set out therein so long as the status of PricewaterhouseCoopers Inc. as successor employer is not resolved nor determined in any way in that process” and except for any notice and severance requirements contained in the collective agreement in respect of the termination by the Receiver subsequent to February 1, 1999. Receiver’s Agreement, supra.

\textsuperscript{1178} Ibid. at 2.

\textsuperscript{1179} Collective Agreement between Med-Chem and the Union, dated November 26, 1996, amended by Memorandum of Agreement dated August 18, 1998, at Article 2.03. The Collective Agreement specified that employees could not be discharged without just cause and specified that lay-off would only occur where there was no work that the employee is capable of performing available to her. It specified that the corporation could use a maximum of thirty non-bargaining unit temporary, casual, part-time workers or outside contractors, so long as these employees did not cause or prolong a layoff or a reduction of regular hours to bargaining unit employees. This did not include doctors or medical professional consultants.
However, the Receiver made no representation regarding the duration of employment. Moreover, the Union agreed not to pursue the successor rights issue and not to bring any successor rights proceeding against a prospective third party purchaser prior to the closing of a sale transaction with such a purchaser.\textsuperscript{1180} In essence, the Receiver was able to secure the continued services of the workers without any liability being imposed on it in terms of outstanding wage, vacation, and pension or health benefits. The Receiver was attempting to avoid the problem in the St. Mary's case, discussed in chapter 3, in which the Receiver was found to be a successor employer within the meaning of pension legislation.\textsuperscript{1181} The Receiver/Union Agreement also specified that the business of the corporation would be sold and that on sale and wind-up, the workers' employment with the Receiver would be terminated. Thus, the Agreement excluded obligations by the Receiver for notice and severance obligations under the Collective Agreement.\textsuperscript{1182} The Agreement specified that for purposes of the Employment Standards Act, the employees would be deemed to have commenced employment with the Receiver on February 1, 1999 on a week to week temporary basis for a period of up to thirteen weeks or duration of the receivership, whatever was shorter.\textsuperscript{1183}

\textbf{C. The Sale Process by the Receiver}

The Receiver established a court-approved process and schedule to govern due diligence, solicitation, consideration and acceptance of offers for an asset purchase.\textsuperscript{1184} Included in

\textsuperscript{1180} Receiver/Union Agreement, supra, note 1171 at 3.

\textsuperscript{1181} St. Mary's Paper, supra, note 1171; see also John Whyte, "Employee Rights in Insolvencies, the Obligations of Trustees and Receivers – An Overview", CBAO, Emerging Issues in Insolvency Law, January 18, 1991.

\textsuperscript{1182} Fourth Report of Receiver, supra, note 731 at paragraph 14.

\textsuperscript{1183} It was specified that this was pursuant to the Employment Standards Act and subject to earlier termination in accordance with the termination provisions of the ESA. Ibid. at paragraph 3.
the court-sanctioned guidelines was a final date for submission of binding letters of intent by March 12, 1999; a period of clarification and settlement of offers received; and a period for the Receiver to communicate acceptance of an offer to the successful bidder on or before March 31, 1999, with the ability of the Receiver to extend the date to April 30, 1999.\textsuperscript{1185} The Receiver prepared an information memorandum for those interested in making an offer and willing to enter into a confidentiality agreement with the Receiver.\textsuperscript{1186} The Receiver then received several offers for all or part of the assets by March 12, 1999, none of which were immediately acceptable to it.\textsuperscript{1187} 

During this period the Union had worked very hard to try to develop an arrangement with Savage Walker Capital Inc. in association with the Teachers’ Pension Plan. The parties had worked out the terms of a five-year collective agreement including a contribution of $1 million of the Union’s money as well as $10 million in compromise of wages and benefit claims.\textsuperscript{1188} An offer by Savage Walker was thus one of the offers submitted to the Receiver. However, Savage Walker could not complete its due diligence in time and its offer of March 12, 1999 was dependent on finalizing financing arrangements.\textsuperscript{1189} The Receiver then contacted Savage Walker about waiving the financing condition. It asked the Receiver for two business days to complete the due diligence necessary to remove the financing condition from its bid, and the Receiver refused to allow the Pension Fund two days to accomplish this.\textsuperscript{1190} It is odd that the Receiver would not agree to this.

\textsuperscript{1184} Order of Justice Gans dated February 19, 1999 (the Sale Process Order); First Report of Receiver, dated February 17, 1999.

\textsuperscript{1185} Third Report of Receiver, supra, note 1140 at paragraph 18.

\textsuperscript{1186} Third Report of Receiver, ibid. at paragraphs 16, 17; Sale Process Order, supra, note 1184.

\textsuperscript{1187} Third Report of Receiver, ibid. at paragraphs 20, 21.

\textsuperscript{1188} Nelson, supra, note 1147.

\textsuperscript{1189} Apparently the Union had been a minor participant in this initial offer. The new offer was made to the receiver on the same day that it released its motion record on April 12, 1999, disclosing the general contents of the CML offer. Fourth Report of Receiver, supra, note 1140 at paragraph 6.

\textsuperscript{1190} Affidavit of Nelson, supra, note 1147 at paragraph 26.
particularly since this was still two weeks prior to the Receiver’s own deadline in terms of consideration of offers.

CML had also placed a bid and began to pressure the Receiver to bring the bid process to conclusion as soon as possible. It advised the Receiver that it wanted a response to its offer by Friday, March 19, 1999, prior to the date set out in the sale process. Given the time sensitive nature of the process, the Receiver then quickly determined that the CML offer was the “highest and cleanest” offer submitted. It entered into negotiations on March 20, 1999 and concluded a purchase and sale agreement that same day, subject to court approval. The Receiver reported to the Court that it was concerned that the offer would be withdrawn if it did not make a decision quickly. The Receiver also reported to the Court that it considered the following factors: the purchase price, likely recovery for creditors, potential claims against the estate, the assets to be purchased, and terms and conditions. It reported that it was aware that the offer would result in a number of employees not being offered employment. The Receiver advised the Court that it had considered the Savage Walker offer that included employment for substantially all of the existing employees, but rejected it because the return was not quite as high for unsecured creditors and because the offer was conditional on finalization of the financial arrangements. Those involved in the case have observed that the Receiver’s decision to accept the offer was an example of the “bird in the hand” phenomenon in which the Receiver opted for a firm offer when CML threatened to withdraw it. In the exercise of its own obligations, the Receiver cannot risk losing a firm bid and possible loss of opportunity to satisfy creditors’ claims.

1191Factum, supra, note 1140 at paragraph 13.

1192Ibid. at paragraph 14.

1193Ibid. at paragraph 16.

1194Ibid.

1195Ibid. at paragraph 15.

1196Mario Forte, Counsel in Med-Chem, supra, note 1140, for Brewery Workers’ Union, telephone interview (25 June 1999); Derrick Tay, Counsel in Med-Chem, ibid. for Savage Walker Capital, telephone interview (5 August 1999), Nelson, supra, note 331.
Although all parties knew that CML would not walk away from the bid, CML was able to use its strategic bargaining power to pressure the Receiver to act before the end of the sale process period.\(^{1197}\) Once the Receiver accepted the deal, it was very difficult to keep any potential investors interested in challenging that decision.\(^{1198}\)

The Receiver made a motion to the Court for an order approving the sale of certain assets of Med-Chem to a numbered company which was a wholly owned subsidiary of CML.\(^{1199}\) CML had agreed to pay $105 million for a significant portion but not all of the assets.\(^{1200}\) CML was not acquiring the main laboratory that employed more than 450 workers and that operation was to be wound up and the workers discharged from their employment. The Receiver indicated that if the inventory and equipment of the main lab were not sold in a timely fashion, it would “mothball them”.\(^{1201}\) The conditions imposed by CML on the offer included that it acquire the license and Corporate Cap from the Ministry of Health prior to the closing date.\(^{1202}\) This was a significant condition of the CML offer given that it is the Cap that essentially guarantees a certain level of business income to the purchaser. The purchase price was also conditional on the full amount of the corporate cap being transferred. If it was not, the purchase price would be reduced by $1.50 for every dollar of the corporate cap not transferred on closing.\(^{1203}\) There were also a number of other pricing conditions relating to laboratory management agreements.

\(^{1197}\) This is not unlike some of Posner and Kordana’s observations regarding strategic bargaining in restructuring cases, in which the optimal outcome of the proceeding is distorted by strategic bargaining by more powerful parties, supra, note 191 at 191.

\(^{1198}\) Nelson, supra, note 331.

\(^{1199}\) 1339821 Ontario Limited, Factum of Receiver, supra, note 1140 at paragraphs 2,3.

\(^{1200}\) Factum of Receiver, ibid. at paragraph 18.

\(^{1201}\) Third Report of Receiver, supra, note 1140 at paragraph 36.

\(^{1202}\) The Ministry of Health had advised the Receiver that the Corporate Cap could not be shifted to CML based on the structure of the CML Asset Purchase agreement and existing health care regulations. The closing date was April 15, 1999. This condition did not sink the deal because all potential purchasers were in the same position.

\(^{1203}\) Ibid. at paragraph 29.
and any decrease or increase in the Corporate Cap in the 1998/99 fiscal year by the Ministry, provided that a maximum aggregate increase or decrease did not exceed $5 million. The offer was subject to Court approval. The Receiver also sought court approval of settlements with the joint venture companies in which Med-Chem held an interest because sale of the entire corporate cap, including the part attributable to the joint ventures, was part of the deal with CML. The sale of assets to CML and a future sale of the remaining assets of the corporation would result in full payment to secured creditors and provide for substantial recovery to unsecured creditors. The Receiver thus advised the Court that the CML offer was the best available to the Receiver at the time it was accepted.

The Union opposed the motion by the Receiver for approval of the sale of assets. It asked the Court to exercise its discretion not to approve the sale of assets to CML and to direct the Receiver to entertain an offer tabled by Savage Walker. This was essentially the same offer as before but with the financing condition removed.

A group of landlords representing a minority of the sites in which the corporation had operated medical laboratories or specimen collection centres also supported the Union's

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1204 Ibid. at paragraph 29.
1205 See supra, note 1142 for a description of these holdings.
1206 Factum of Receiver, supra, note 1140 at paragraph 18, 20. The Receiver advised the Court that it was in the best interests of the estate that all of the offers and the terms and conditions of CML agreement be kept strictly confidential, although it was provided to the Court under seal.
1207 Factum of Receiver, supra, note 1140 at paragraph 34.
1208 Notice of Motion of Brewery, General and Professional Workers' Union, Med-Chem, supra, note 1147 (13 April 1999).
1209 Fourth Report of Receiver, supra, note 1140 at paragraph 7. The offer was also conditional on transfer to the Purchaser of leases necessary to carry on the business; no material adverse change in Med-Chem’s business between March 12, 1999 and a closing on May 31, 1999; and on the Receiver delivering an ongoing management contract.
motion.\textsuperscript{1210} The landlord group asked the Court not to approve the sale to CML, requesting that it take into consideration the overall benefit to the community and stakeholders, including the benefit to landlords, doctors and patients who would be adversely affected by the implementation of the CML proposal.\textsuperscript{1211} The landlord group also argued that the Receiver had failed to take account of the unwillingness of CML to negotiate with landlords in a commercially reasonable manner, negotiating in a heavy-handed manner at severely discounted prices.\textsuperscript{1212} It supported the Savage Walker offer because the Pension Fund had committed to negotiating in a commercially reasonable manner, had undertaken to minimize the closure of laboratories, and thus continue to enhance the social and economic life of the community.\textsuperscript{1213}

The Savage Walker bid price had a stated value of $105 to $110 million.\textsuperscript{1214} Unlike the CML offer, this offer was not conditional on possible price adjustments because of anticipated claw-backs by the Ministry of Health.\textsuperscript{1215} The proposal included retaining all of the employees except a few managers. It also included a commitment by the Union to waive all claims to outstanding wage and benefit arrears, enhancing the value of the offer by $9.2 million. This was the Union's financial contribution to the offer. It was prepared to compromise its claims in an effort to retain employment for the workers that it represented. The Union and Savage Walker argued that this waiver by the Union made

\begin{footnotes}
\textsuperscript{1210} Motion Record of the Landlord Group in the matter of Med-Chem Health Care Limited. Court File 98-CL-3200, dated April 14, 1999; the landlord group represented only 8 of 150 sites, Med-Chem, supra, note 1140, Order (15 April 1999), Gans J..

\textsuperscript{1211} Ibid. at paragraph 2. Its view was that the offer by CML failed to take account of these interests, including providing patients and doctors with convenient access to laboratory tests and prompt reporting of results.

\textsuperscript{1212} Ibid. at paragraph 6.

\textsuperscript{1213} Ibid. at paragraphs 17, 18.

\textsuperscript{1214} Memorandum of Savage Walker Capital Inc., dated April 8, 1999 at 1. Motion Record, April 15, 1999. This included a bid price of $95 million and an additional 415 million in waivers of liability and tax benefits.

\textsuperscript{1215} Offer to Acquire the Assets of Med-Chem Health Care Limited and other related assets, Savage Walker Capital Inc., April 8, 1999.
\end{footnotes}
the offer by the Savage Walker comparable if not superior in value. The Court dismissed the Union's motion and approved the sale to CML.

D. Should the Court have Considered All Investments at Risk in the Corporation?

Canadian courts have applied the following tests in approving a sale of assets: that the Receiver has made a sufficient effort to get the best price and has not acted improvidently; that the Receiver considered the interests of all parties; the efficacy and integrity of the process by which offers were obtained and that there has been no unfairness in the working out of the process. In this case, the Court applied these criteria, but accorded them a narrow interpretation.

One difficulty in assessing the Med-Chem process is that the Union chose to argue many of the issues in its motion based on labour relations considerations. While the Union argued that the Receiver acted improvidently, this argument was based almost entirely on labour relations grounds, as opposed to challenging other actions of the Receiver that on the face of the court record offered stronger grounds to establish that the Receiver had neither fully considered the interests of all creditors nor made a sufficient effort to get the best price. The Union believed that it could establish that the alleged unfair labour practices were “exceptional circumstances” such that the Court should not approve the Receiver's recommendation. Finally, and probably most importantly, the offer the

1216 There was some dispute between the Fund, the Union and the Receiver as to whether all of this liability existed, but no dispute that a sizeable amount of claims were outstanding in terms of workers. Ibid. at paragraph 3.

1217 Soundair, supra, note 698; Red Cross, supra, note 1022.

1218 This is notwithstanding the fact that the Union retained insolvency counsel.

1219 Bob Armstrong, Counsel in Med-Chem, supra, note 1140, for the Brewery Workers' Union, telephone interview (18 June 1999).
Union was asking the Court to compare was not the one submitted before CML’s offer was accepted, but rather one submitted well after the acceptance.

The Union asked the Court to exercise its discretion not to approve the sale and instead to approve the proposed bid of Savage Walker.\(^\text{1220}\) The Union argued that approval of the CML offer would allow the Receiver to facilitate a breach of the Collective Agreement and the Receiver/Union Agreement resulting in the unlawful termination of more than 450 employees.\(^\text{1221}\) The Union further argued that approval and implementation of the CML offer would result in breaches of the Ontario Labour Relations Act because the proposed transaction by CML through a numbered company was structured in such a manner as to avoid purchasing a lab that was unionized.\(^\text{1222}\) The Union asked the Court to have regard for all the circumstances, to take into consideration the overall benefit to the community and stakeholders, including benefits to suppliers, landlords and workers whose jobs would be lost.\(^\text{1223}\) The Union thus asked the Court to exercise its jurisdiction to decline to accept the Receiver’s recommendation, arguing that exceptional circumstances existed.\(^\text{1224}\)

The Union’s position was that as an officer of the court, the Receiver has an obligation to act honestly and in good faith on behalf of all interested parties involved in the sale of the

\(^{1220}\) Med-Chem, supra, note 1140, Written Submissions of the Brewery, General and Professional Workers’ Union, Responding to Motion of Receiver for Approval of the Sale of the Assets, [hereinafter Written Submissions] at paragraph 1.

\(^{1221}\) Notice of Motion, supra, note 1140 at paragraph 2. The Union submitted that the bid by Savage Walker did not breach either the Receiver/Union Agreement or the Collective Agreement, was comparable in financial terms, and unlike the CML offer, provided for employment of both unionized and non-unionized employees of Med-Chem.

\(^{1222}\) Labour Relations Act, 1995, S.O. 1995, c. 1, sections 56, 69, 70, 72 and 76. Motion Record, Affidavit of Nelson, supra, note 1137 at paragraphs 29, 33. Since the numbered company had no lab itself, the work would be contracted out, contrary to the just cause and layoff provisions that the numbered company would inherit as a successor employer.

\(^{1223}\) Notion of Motion, supra, note 1140 at paragraph 2(f).

Med-Chem assets, as well as to deal with the property in a commercially reasonable manner.\textsuperscript{1225} The Union argued that the standard of care required was one of meticulous correctness, utmost fairness, and a duty to honour all contracts into which it enters.\textsuperscript{1226} It alleged that the Court’s approval of the offer by CML would breach the court-approved Receiver/Union Agreement.\textsuperscript{1227} The Savage Walker bid was financially comparable to the CML bid, and in the Union’s submission, superior as a bid when all of the relevant factors were considered.\textsuperscript{1228} Both bids satisfied all of the claims of secured creditors. In addition, the going concern value should have been calculated to account for savings to the estate of Med-Chem in costs that would not be incurred for termination of various supplier and landlord contracts.\textsuperscript{1229} Landlords and suppliers would be materially better off from the continuation of business, continuation of leases and supply demand.\textsuperscript{1230} The Union also argued that the preservation of employment was of significant and indisputable value to the community, relying on the Court's reasoning in \textit{Skydome Corporation} in this respect.\textsuperscript{1231} The Union argued that there were exceptional circumstances such that the Court should exercise its discretion not to approve the sale. Here the Savage Walker offer did not breach labour contracts or labour legislation; employees, the community and certain stakeholders would be put in a superior position while remaining creditors were in an equally advantageous position; and preservation of


\textsuperscript{1226} \textit{ibid.} at paragraph 5.

\textsuperscript{1227} The Union argued that the acceptance by the Receiver of offers to purchase should have been in accordance with the Receiver/Union Agreement, and thus with its commitment to abide by the terms of the Collective Agreement. It argued that the breaches that would occur with approval of the sale of assets to CML were breaches of two very fundamental provisions in the Collective Agreement, the just cause and contracting out provisions. The Court in disposing of this issue determined that factually the Receiver did not breach the agreement not to contract out because it continued to employ unionized members during the transition period prior to the sale. \textit{ibid.} at paragraphs 7, 8, 13, 14.

\textsuperscript{1228} \textit{ibid.} at paragraph 2.

\textsuperscript{1229} \textit{ibid.} at paragraph 37.

\textsuperscript{1230} \textit{ibid.} at paragraph 43.

\textsuperscript{1231} \textit{ibid.} at paragraph 39, 44.
455 jobs was of value to the community. Moreover, the Union argued that the CML offer resulted in irreparable harm from closure of the central laboratory, and that there was no timely and effective remedy for the workers discharged as a result.

The Court's decision focussed on whether the Court ought to interfere with the recommendation of the Receiver. Justice Gans held that when a Receiver's sale is before the court for confirmation, the only issues are the propriety of the conduct of the Receiver and whether it acted providently. The Court held that its function is not to step in and do the Receiver's work. The Court found that no one took issue with the integrity or propriety of the Receiver's actions. The CML deal would satisfy the claims of secured creditors and many of the unsecured claims. The Court concluded that the Receiver made every effort to get the best price. The Court dismissed the argument that the Receiver had acted improvidently because acceptance of the sale offer resulted in the dislocation of 455 people. It held that the Court is to examine the conduct of the Receiver in light of the information the Receiver had when it agreed to accept the offer, and that the Court should be cautious in making determinations based on information that came to light after its decision. The Court then concluded that it would not review the Savage Walker offer because the Receiver's views of the business matters were not to be "second-guessed or placed under a microscope", and because the Court should not reject the recommendation of the Receiver except under the most exceptional circumstances. Loss of 450 jobs were not exceptional circumstances such that a

1232 Ibid., citing Crown Trust, supra, note 132 at 109.
1233 Ibid. at paragraph 50.
1235 Ibid. at paragraph 9.
1236 Ibid. at paragraph 6.
1237 Ibid. at paragraph 10.
1238 Ibid. at paragraph 11.
1239 Ibid., citing Soundair, supra, note 1232 at 7.
1240 Ibid. at paragraphs 12, 15, citing Crown Trust Co. v. Rosenberg (1986), 60 O.R. (2d) 87 (H.C.).
previously accepted offer should be rejected in favour of a late bid. The Court concluded that the Receiver’s assertion that the CML deal was equal to or better than the proposed Savage Walker deal "brings any further inquiry into comparison of the deals to a halt".\textsuperscript{1241} The Court held that it should not entertain offers tabled at the eleventh hour because it plays havoc with the process and that there had been plenty of time to engage the Receiver in some form of auction prior to March 20, 1999.\textsuperscript{1242}

To this point, the Court is clearly concerned with protecting the process by which Receivers in bankruptcy proceedings conduct sales of the assets and with protecting the integrity of a bidding process from assault by \textit{ex post facto} bids being used to justify the intervention of the Court. The facts in this case are thus completely dissimilar from a case in which two competing bids were submitted, one of which retained the existing workers and the Receiver chose one which would lead to massive loss of employment. No issue of the integrity of the bidding process would arise in such circumstances and the court would be able to deal directly with the balancing of interests by a Receiver in considering two such bids.

Unfortunately, the sequence of events in the \textit{Med-Chem} proceeding meant that by the time the Court was being asked to make a decision on the sale of the assets, other values, such as upholding the integrity of the process by which Receivers sell assets, had to be taken into account in the Court’s decision. This consideration took precedence over the balancing of diverse interests of parties in the sale decision. While the Savage Walker bid was not an eleventh hour offer in the traditional sense, given the events I have set out above, it was nevertheless an eleventh hour offer in terms of being made after the other offer was accepted. There are good policy reasons for refusing to allow an unsuccessful bidder to overturn acceptance of another offer by changing its offer after the other bid was successful.\textsuperscript{1243} While the result can arguably be justified as a necessary protection

\textsuperscript{1241} \textit{Ibid.}
\textsuperscript{1242} \textit{Ibid.} at paragraph 19.
\textsuperscript{1243} The change here being removal of the financing condition.
by the Court of the integrity of the sale process, the Court’s decision goes beyond this as a ground for denying the motion and appears to return to a much narrower understanding of the interests that must be considered and balanced by the Receiver. However, because the Court felt that it could not undertake a direct comparison of the two offers due to the acceptance of one before the other one was submitted, the decision should not be taken as precedent for the proposition that workers’ equitable investments should not be a factor in the assessment of two relatively comparable offers submitted for consideration at the same time. It might have been more helpful if the Court had clarified that if the issue had come before the Court in the form of a pure competition between the two offers, then the court would have seriously considered whether the Receiver had balanced all the interests of and prejudice to stakeholders. Such a clarification may have avoided the impression that the Court was declaring that workers’ loss of human capital investments should be considered exclusively in the labour relations forum.

The entire scheme of priorities governs whose interests should be given weight by the Receiver. In this case, the only value being considered was the amount of return on the fixed claims of traditional creditors. Yet if both offers had been timely, they would both have satisfied all secured creditors. Therefore, any balancing that should have occurred should have been a balancing of the interests or prejudice among the unsecured creditors. Here, even without considering the equitable claims of workers in terms of their human capital investment, their fixed claims alone made the 900 workers the largest group of unsecured creditors. However, with only one offer being timely, the Court never engaged in a balancing of interests.

While the Court properly deferred the question of unfair labour practices to the Labour Relations Board, it did not indicate that in a proper case the issue of loss of human capital investment is relevant to insolvency and bankruptcy proceedings. It declined to consider whether the alleged labour violations created exceptional circumstances, yet curiously, its deference to the labour relations forum had not prevented the Court from earlier granting the Receiver’s motion for an order that the Receiver was not a successor employer for labour relations purposes. The relationship between the Court’s granting of
these types of orders in order to protect Receivers from the ordinary consequences of collective agreements and labour relations law, and the deference exhibited towards labour relations tribunals when it is asked to assess the behaviour of the Receiver needs further development and explanation.

The Union immediately moved to set aside the order of Justice Gans before the Ontario Court of Appeal. The grounds for which it sought appeal were that Justice Gans had erred in law in approving the sale of assets to CML given the purchaser’s admission of structuring the offer to avoid meeting its obligations under labour relations legislation; and that the Court failed to take into account that approval of the offer to purchase by CML would result in breaches of the Collective Agreement, Receiver/Union Agreement, and the Labour Relations Act. The Union further argued that the Court erred in approving the offer to purchase by failing to take into account that the offer would result in the termination of 450 employees. It also argued that Justice Gans failed to exercise his discretion in the circumstances of the case, given that a dominant objective of the CCAA and BLA were to preserve as many jobs as possible.

The Court of Appeal dismissed the stay motion. Based on the record before it, the Court of Appeal engaged in the appropriate decision-making process. Justice Laskin held that Justice Gans was entitled to the deference of the court on appeal and that he had not exercised his discretion unreasonably nor had he committed an error in principle. The Court held that Justice Gans had not committed a reviewable error in finding that there were no exceptional circumstances such that he should exercise his discretion to

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1244 CCFL Subordinated Debt Fund and Company, Limited Partnership and Med-Chem Health Care Limited/ Soins de santé Med-Chem Limitée, Notice of Appeal to Ontario Court of Appeal, (15 April 1999), Court File C31957. It asked that the order of Justice Gans be set aside and that an order be granted approving the offer to purchase the assets of Med-Chem pursuant to the Savage Walker offer.

1245 Ibid. at paragraph 2.

1246 Ibid. at paragraphs 1-7.

refuse the recommendation of the Receiver. The Court noted that all parties had acknowledged that the Receiver acted properly, had balanced the interests of creditors with concern about job loss, had tried to get the best price and considered the interests of all the parties. The Court of Appeal agreed that there was no reason to interfere with the Receiver's judgment. The Court held that "deference to the Receiver overlaid with deference to the court makes it exceptionally difficult for the Union to succeed in this court". The Court of Appeal noted its wariness of entertaining last-minute offers, deferring to the integrity of the bidding process and the Receiver's opinion that the offer was not as favourable. The Court held that "As Blair J. observed in the Skydome case, though a receiver must consider the social consequences of receivership, that consideration should not outweigh the lawful interests of creditors. The Receiver here acted in accordance with Blair J.'s observation". Given that the record before it was that the Receiver had considered the interests of all the parties and had tried to get the best price, the Court of Appeal engaged in the same kind of balancing as the Court undertook in Skydome Corporation.

E. Lessons from Med-Chem

Med-Chem illustrates that there are other factors in the current regime that may operate as limits to the court's willingness or ability to consider the equitable interests of diverse stakeholders. The need to protect the integrity of the sale process is one such limit. While the Court may have correctly deferred to the Receiver in order to protect the

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1248 Ibid. at paragraph b.
1249 Ibid. at paragraph 1(b).
1250 Ibid.
1251 Ibid. at paragraph 1(c).
1252 Ibid. at paragraph 1(e).
integrity of the sale process, the Court's conclusion that the issues raised by the Union are concerns exclusively relating to labour law fails to give recognition to the interest and investment of workers as both fixed capital and equitable claimants in the bankruptcy proceedings.

At best, *Med-Chem* represents an uneven application of the ideas set out my framework. The initial proceedings recognized and accorded a role for the Union from the outset. Thus human capital investments were considered an important part of the equation. This recognition was greatly facilitated by the Chair of the Restructuring Committee under the *CCAA* part of the proceedings, as well as one senior secured creditor. The participation of the Union reflected the type of participation rights that I have suggested in chapter 2.

However, the case illustrates the very fine line between effective case management and the need for flexibility in the process. While most would agree that a debtor corporation should not be allowed to languish in *CCAA* proceedings, the short time frames imposed by the Court in the face of multiple bidders and potential investors was almost unprecedented in *CCAA* applications for an enterprise of this kind. In just less than two months, including the Christmas season in which it is difficult to get decisions made, the corporation was declared bankrupt. If the aim is to maximize enterprise value, then where there is potential for the parties to negotiate a workout acceptable to all debt, equity and equitable stakeholders, the process must be flexible enough to allow the parties to try to reach consensus. Greater flexibility is required in terms of pacing the proceedings in order that the parties are able to negotiate arrangements and compromises, particularly in this case where there were multiple stakeholders and sites to consider, and where there was enormous potential for a viable business plan. While practically speaking, human capital investments will rarely prevail in such proceedings given the priority and quantum of claims, the objective should be to create the optimal decision-

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1254 Houlden, *ibid.*
making process that allows parties to undertake negotiations that seek to balance the various interests and perhaps to reach consensus on a plan of arrangement.

Moreover, where time frames are too tightly imposed, the process will work against those stakeholders who must build some consensus in order to put together a restructuring package. Industry investors are at a competitive advantage because they know the industry and have established lenders that also know the commercial potential of purchase of a competitor’s business in terms of both enhancing value and reducing competition.1255 U.S. vulture funds, while more general, can afford some losses because of the large amount and variety of investments and ability to spread risk; thus they are able to act quickly in restructuring processes to offer funding and secure priority.

In contrast, pension funds or other institutional investors have more rigorous due diligence requirements and must also seek approval decisions at multiple levels of the organization. Thus, frequently they can only give expressions of interest or make conditional offers. Their decision making processes, while protective of pension and other beneficiaries, are not particularly conducive to the insolvency context where time is of the essence.1256 This is particular so because such investors cannot inject capital unless there is fairly low risk to the investment. Given that the fact of insolvency creates additional risk, the due diligence in such cases is even higher and thus requires more time. Given that these investors are often the only source for workers and other non-traditional creditors to obtain investment funds, inflexibility in the process will necessarily lead to outcomes that favour industry investors. While industry investors are an important source of funds, rigid time frames should not act as a bar to investors who are more likely to recognize the interests of workers, local suppliers and other

1255 Tay, supra, note 1196.

1256 Ibid. The amount of discretionary investment is not enough to allow effective and expeditious investment in restructuring and there is a time delay in approvals.
stakeholders. In turn, it is equally important that for pension funds and similar institutional investors considering such investments, that their mechanisms are better tailored to expedite decision making. Generally speaking, the Court in its supervisory capacity must monitor the progress for negotiations for a plan of arrangement and failing to recognize the organic nature of these processes, particularly where there is a viable business at stake, will lead to firm failure. 1257

1257 Houlden, supra, note 1139.
CHAPTER 9

COMPARATIVE ANALYSIS OF OTHER JURISDICTIONS

Most industrialized countries have implemented schemes for the liquidation or reorganization of businesses that are in financial crisis. Depending on whether the particular jurisdiction has adopted what is primarily a debt collection model or a rehabilitation model, the regime accords different responsibilities and obligations to traditional creditors, debtor corporations, workers, other stakeholders, the courts and their officers.

To this point, I have focused on how my policy objectives of enterprise wealth maximization and recognition of human capital, debt, equity, capital and other investments should be recognized in Canadian restructuring law. While I make reference to the need for other policy instruments such as a national wage protection scheme in chapter 3, a discussion of these instruments is beyond the scope of this text. It is important to note, however, that such schemes may be an optimal way to protect workers' human capital investments, although it is unclear how they could be crafted to protect the other components of the "public interest" or equitable investments that I have discussed. What is clear is that my ideas are only one part of the equation to protect the diverse investments of workers and others, just as corporate restructuring is itself one part of a much larger scheme in the priority and enforcement of credit. In the same vein, while this chapter canvasses several other jurisdictions, one must be cautious in drawing definitive conclusions regarding comparative restructuring schemes, given that a particular jurisdiction may have adopted other, more effective instruments for protecting human capital and other investments. Thus, while I have suggested that Canada's
restructuring regime offers the optimal model for incorporating my ideas, I am not suggesting that overall, Canada's statutory regime is optimal in protecting equitable investments. Other jurisdictions have been much more effective in creating labour adjustment and retraining schemes, wage protection mechanisms, and other instruments. This chapter engages in a comparative analysis only of the restructuring schemes, with a view to assessing their ability to achieve enterprise wealth maximization by recognizing equitable investments and by creating timely and accessible participation and decision rights.

The chapter is not integral to development of my thesis. Why include it, one might ask. There are two reasons. The first is that I conclude that while the regimes are not converging in their primary policy objectives or policy instruments, all have recognized that there is a need to provide an alternative to liquidation in order to preserve going concern value where appropriate. All of these regimes have attempted to grapple with notions of "public interest" and how the interests of stakeholders beyond traditional debtors and creditors can be recognized in the process. Each jurisdiction has attempted to strike a balance between these "public interest" concerns and recognition of the importance of an effective system of credit enforcement, that balance situating itself depending on the primary policy objective of the scheme in terms of rehabilitation or debt collection. Second, international comparisons are difficult because of the different legal, political and economic systems that have shaped the evolution of insolvency regimes and that continue to guide decision-making in these jurisdictions. We have a tendency, therefore, to conclude that if there are not immediate discernable lessons that support our ideas, that it adds nothing to the debate to include an analysis of other jurisdictions. Nothing could be further from the truth. Knowledge of other jurisdictions enhances our understanding of our own regime. It can also reinforce some of our intuitive conclusions regarding particular policy instruments such as restructuring, specifically, that the evolution of our regime is a comparatively optimal one.

This chapter thus briefly explores five jurisdictions in order to gain a better understanding of how insolvency schemes have attempted to reconcile traditional creditors' claims to
the value of the insolvent corporation's assets with recognition of the public interest of preserving going concern value, jobs and the economic life of communities. It is beyond the scope of this thesis to analyze in detail how each of these jurisdictions operates or to evaluate their effectiveness as a comprehensive regime. Rather, I have selected five jurisdictions that are illustrative of how other regimes have dealt with some of the notions that I set out in chapter 2. Three are what scholars would characterize as rehabilitation jurisdictions, the United States, Mexico and France. The other two jurisdictions, Germany and the United Kingdom, have regimes that are very debt collection or creditor oriented. The choice of regimes discussed is necessarily somewhat arbitrary and attempts to undertake a selective comparison rather than provide a broader comparative analysis. While the insolvency issues faced by a number of developing countries such as those in Asia are vitally important and interesting, I have confined myself to jurisdictions with a more developed insolvency scheme so that I can best draw from their collective experience.

The United States was selected for comparative purposes because of its similar economic structure and because of the importance of cross-border insolvency proceedings in Canada and the United States. It is illustrative of the difficulties that arise in protecting creditor's rights when the scheme is aimed too exclusively at a policy objective of rehabilitation. Mexico was chosen because of the increasing amount of investment by Canadian firms and the recent tri-national insolvency initiatives with the advent of the North American Free Trade Agreement (NAFTA). It best illustrates that there needs to be effective judicial oversight or the scheme will either fail to accomplish its rehabilitation and public interest objectives or will develop a parallel private law forum to meet the exigencies of restructuring.

France's model offers support for the feasibility of my ideas. While its principal policy objective is rehabilitation, its policy instrument of early and preventive intervention serves to protect and enhance creditors' investments, including those of non-traditional creditors such as workers. While other jurisdictions formally recognize the public interest in job preservation, they do not make full use of workers' informational and
organizational capital in decision-making. Only France has expressly embraced the idea of enterprise wealth maximization, although there is some recent caselaw in the U.S. that indicates a slight movement in this direction.

The two remaining comparative jurisdictions, the United Kingdom and Germany, were selected because their debt collection regimes serve as alternative models of insolvency law. The U. K. is significant because Canada's early bankruptcy laws were modeled after U.K. legislation. The schemes then diverged, with Canada shifting more towards some element of rehabilitation. What is significant about these regimes is that while they continue to have a primary policy objective of debt collection, they have recognized the need to develop viable restructuring schemes to preserve going concern value where it preserves value for creditors and other stakeholders. The instrument through which this objective is accomplished varies. In Germany for example, there is a co-determination model of corporate governance in which workers are given some access to decision making in the solvent firm. On insolvency, workers are not accorded special rights because they already have exercised their monitoring and governance role earlier in the process.

The five regimes are briefly described in the context of the ideas set out in this text. As a consequence, the descriptions of the regimes are far from comprehensive and the reader would be well advised to consult the many comparative studies undertaken by insolvency scholars. I describe how the schemes have adopted a policy objective of the value of workout schemes, but conclude that those objectives differ considerably when coupled with a primary policy objective of debt collection or rehabilitation in a particular regime. I then explore how the schemes have converged or diverged in terms of other objectives of my framework, specifically: maximizing enterprise wealth; according an enhanced role in decision-making for workers and other stakeholders; and finally, reconciling the rights of traditional creditors with other stakeholder interests. I commence my analysis

with the rehabilitation jurisdictions and then turn to those that are debt collection oriented. I conclude that, comparatively, Canada’s restructuring regime offers the greatest potential for the effective reconciliation of traditional creditor interests with the interests of others with investments in the firm. This is the result of Canada’s multiple insolvency law objectives and because of its approach to the balancing of traditional creditor rights with the complex interests involved in consideration of the “public interest”.

A. The Policy Objective of Having An Effective Workout Scheme

In chapter 2, I endorsed the explicit recognition of the value of restructuring schemes that forms part of Canada’s insolvency regime. In undertaking comparative analysis of other relatively mature insolvency regimes, whether debtor or creditor-oriented, it is notable that in each there is public policy recognition of the value of mechanisms to allow corporations to restructure, although the regimes vary considerably in their underlying objectives and in according decision rights. This is because restructuring can enhance value for creditors as well as debtors, as was evident in my discussion regarding the convergent and divergent interests of various creditor groups. In the creditor-oriented jurisdictions such as Germany and the United Kingdom, the efforts to facilitate restructuring are fairly recent initiatives that have been implemented to address problems of premature liquidation. In contrast, some jurisdictions that aim at rehabilitation, such as the United States, have faced severe criticism for failing adequately to respect the pre-insolvency rights of traditional creditors. First I briefly describe the rehabilitation jurisdictions in terms of their key policy instruments and objectives that reflect public policy on the value of workouts. I then discuss what can be discerned from their respective choices regarding wealth maximization, recognition of other stakeholder interests, and balancing of traditional creditor rights with other interests.
i. **The Public Policy Objective of Rehabilitation:**

**Chapter 11 of the U.S. Bankruptcy Code**

Turning first to the United States, Chapter 11 of the United States Bankruptcy Code provides a mechanism for solvent or insolvent corporations to seek the protection of the court pending acceptance of a plan of reorganization. The objective of rehabilitation is reflected in numerous statutory provisions. For example, the debtor corporation has a period of 120 days in which it exclusively can propose a reorganization plan. It then has an additional 60 days to have the plan accepted by creditors. The U.S. courts frequently extend this period of exclusivity, thus giving the debtor corporation greater control over the proceedings for prolonged periods of time. Comparatively, the U.S. differs from the Canadian regime in that creditors’ rights are stayed for prolonged periods without the debtor having to be accountable to creditors and without creditors being able to propose plans themselves.

Under Chapter 11, when a party files a petition, an automatic stay is imposed on both secured and unsecured creditors. The business continues to operate with the debtor in possession (DIP). The DIP actually controls a new legal entity, the estate, acquires rights

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1259 Ziegel and Cuming suggest that American legislation is the most debtor oriented in the world, supra, note 2 at 760.

1260 Section 1121(b), (c), Bankruptcy Code, supra, note 83. The extended stay creates an incentive to carry on business even where the value of the enterprise is worth more liquidated. Interest continues to accrue on secured debt, but not on unsecured or undersecured debt. Debt forgiveness is fully taxable in private workouts but not under Chapter 11 reorganizations. Moreover, there is greater ability to avoid legal judgments and it is easier to restructure assets under Chapter 11. Franks and Torous, supra, note 199 at 458-9. The stay period provides protection while the DIP negotiates with creditors and provides a court supervised process where issues cannot be resolved between parties.
and obligations of a trustee in bankruptcy, and is now acting on behalf of all the creditors. Creditors can ask the court to lift the stay for purposes of enforcement of their security if they can establish that it is necessary for the protection of their interests, although courts will not interfere lightly with the exclusive period. Under Chapter 11 proceedings, the debtor corporation has the right to reject unfavourable contracts and assume valuable ones; there is suspension of accrual of interest on unsecured liability; there are clearer rules for the granting of debtor in possession financing; and there is the availability of “cram down” as a means to obtain approval of plans over the objections of dissenting creditors. As a consequence, under the U.S. scheme, the debtor corporation has greater bargaining power and can stay creditors’ interests for long periods while it devises a strategy to rehabilitate itself.

The difficulty with Chapter 11 is that the scheme can be used to defer liquidation to the considerable compromise of creditors’ interests. Some studies have shown that only 17% of all Chapter 11 cases result in a confirmed plan of reorganization, although the figure for publicly traded companies is closer to 90%. As with Canadian courts, the U.S. courts

1261 Warren and Westbrook, supra, note 151 at 398. Section 363, Bankruptcy Code, supra, note 83. A trustee can be appointed under Chapter 11, but it is rare. In such cases, the trustee is a fiduciary to all parties with an interest in the estate. Anna Chou, "Corporate Governance in Chapter II: Electing a New Board" (1991) 65 Am. Bank. L.J. 559 at 580.

1262 The Court is required to act on any request to lift a stay within 30 days or the stay is automatically lifted with respect to a creditor’s collateral. The DIP has the onus of demonstrating that there is adequate protection of the secured creditor’s collateral. The court will lift a stay if it determines that there is lack of adequate protection. Ss. 361-2, Bankruptcy Code, supra, note 83. Warren and Westbrook, supra, note 151 at 398, 403, 410, 412. The three tests for adequate protection are: periodic payments, additional or replacement liens, and “such other means of providing adequate protection as will result in the realization by such entity of the indubitable equivalent of such entity’s interest in such property”. A equity cushion can be found to be adequate protection. Re Rogers Development Corporation 2 Bankr. 679 (Bankr. E.D. Va. 1980).

1263 The absolute priority rule and “cram-down” are discussed at note 1434, infra, Part D. Post petition creditors can be offered relatively good credit terms, Warren and Westbrook, supra, note 151 at 399.

1264 Triantis, supra, note 1 at 102-3.

have held that the purpose of Chapter 11 is to provide a period of time in which the debtor corporation can attempt to negotiate a reorganization plan acceptable to creditors.\textsuperscript{1266} Unlike the Canadian scheme, creditors have few rights to insist on an expeditious resolution of the proceedings.

There has been long standing recognition in the United States of the public interest in encouraging corporations to stay in business. Historically, scholars believed that the public interest was protected because of the statutory scheme that allowed the Securities and Exchange Commission (SEC) to supervise reorganizations.\textsuperscript{1267} Early in its history, the SEC was entitled to receive notice of all steps taken, to formulate plans of its own, to inquire into private plans, and to accept the submissions of unions on issues affecting the interests of employees.\textsuperscript{1268} Thus as early as the 1940's, it was accepted in the United States that workers, consumers and the general public had an interest in reorganizations, and that those interests were to be taken into account in reorganization proceedings.\textsuperscript{1269} The new \textit{Bankruptcy Code} in 1978 substantially reduced the role and influence of the SEC. Prior to 1978, the SEC was an active participant in reorganization proceedings;

\textsuperscript{1266} Warren and Westbrook, \textit{supra}, note 151 at 397.

\textsuperscript{1267} \textit{Ibid.} at 396-7. They suggest that the pattern was that companies would file under Chapter XI, the SEC would move to have the case converted to Chapter X, and the parties would end up negotiating for treatment of public debenture holders and shareholders as a condition of the SEC withdrawing its objection to the company remaining in Chapter XI proceedings. Institutional lenders felt that this process was counter to their interests. However, while the procedures required of investigation and approval and may have safeguarded the public interest to some extent, the Chapter X scheme resulted in enormous delay in review and approval by the Securities and Exchange Commission (SEC), often resulting in firm failure. The other problem was that reorganizations under Chapter X required that a trustee in bankruptcy (TIB) take over operations, whereas the more expeditious Chapter XI procedure did not require SEC participation and the debtor company remained in control of the company, albeit with responsibilities of a TIB. Warren and Westbrook point that that after 40 years of publicly held companies trying desperately to qualify under the less onerous Chapter XI, usually without success, that the statutory scheme was amended to essentially merge Chapters X and XI into a new Chapter 11. The concept of Debtor in Possession (DIP) was enshrined in all cases except where there were compelling reasons for appointing a trustee in bankruptcy. Warren and Westbrook suggest that there is obvious loss in protection of public debenture holders and shareholders because of the reduced role of the SEC. The benefit is that corporations are likely to seek protection and assistance earlier, thereby ultimately avoiding additional shutdown and job loss, and creditors losses.

\textsuperscript{1268} \textit{Ibid.} at 593, citing these as the public interest provisions set out in Chapter X of the \textit{Chandler Act}.

\textsuperscript{1269} \textit{Ibid.} at 594.
now it will intervene only on request of the court.\textsuperscript{1270} The impetus for this change was the view that the SEC's role in protecting investor interests had developed to the considerable detriment of trade creditors and workers, and thus was no longer appropriate.\textsuperscript{1271}

Some of these notions of public interest have carried through to today, allowing for the court's recognition of interests such as tort claims. The \textit{U.S. Bankruptcy Code} defines claims broadly to include future claimants and requires participation by anticipated claimants. The courts, in endorsing workable plans, will assess whether funds are set aside to pay future claimants.\textsuperscript{1272} Chapter 11 reorganizations are viewed as having a primary objective of rehabilitation, based on concern for the interests of shareholders, unsecured creditors, employees and the community in which the firm is operating.\textsuperscript{1273} As in Canada, those interests have largely been defined by the corporation itself, rather than by the stakeholders.

Shareholder rights continue unless there is intent to jeopardize the reorganization.\textsuperscript{1274} The \textit{Bankruptcy Code} makes no express reference to corporate governance and scholars have argued that shareholder rights to determine governance matters during insolvency should not be abrogated in the absence of clear statutory directive.\textsuperscript{1275} However, since the U.S. scheme involves a concept of the debtor-in-possession in which the directors

\textsuperscript{1270} Warren, \textit{supra}, note 170 at 469.

\textsuperscript{1271} \textit{Ibid.} at 470. See also R. J. Mann, "Bankruptcy and the Entitlements of Government: Whose Money Is It Anyway?" (1993) 70 N. Y. U. L. R. 993. Mann suggests that the reallocation of bankruptcy goals are justified by distributive justice concerns.


\textsuperscript{1273} Goldstein \textit{et al.}, \textit{supra}, note 798 at 154.

\textsuperscript{1274} This includes the right to elect a new Board of Directors. Anna Chou, "Corporate Governance in Chapter 11: Electing a New Board" (1991) 65 Am. Bankruptcy Law Journal 559 at 571.

\textsuperscript{1275} \textit{Ibid.} at 576.
under Chapter 11 become fiduciaries of the estate rather than the shareholders, this creates a conflict for directors of the DIP since the regime sets up the fiction of the debtor-in-possession, but the directors are still elected by shareholders and accountable to creditors and shareholders.

Legal scholars have criticized the extent to which the scheme protects the debtor corporation, often to the detriment of creditors' interests and ultimately the untimely liquidation of the corporation.¹²⁷⁶ Other scholars point to the many cases in which Chapter 11 has successfully been utilized to assist corporations in a turnaround of their financial affairs, resulting in the preservation of many jobs.¹²⁷⁷ Yet while corporations appear to be successful in the short term, only about 5% of cases survive for any prolonged period outside of bankruptcy proceedings.¹²⁷⁸

Unlike the restructuring provisions of the BIA and the CCAA, a corporation does not have to be insolvent to file for Chapter 11 protection. This is to encourage corporations to file and restructure their affairs before the corporation reaches the point that it is hopelessly insolvent and therefore unlikely to reorganize successfully.¹²⁷⁹ The stay provisions promote the policy objective of rehabilitation. However the length of the stay period, including the availability of numerous extensions of the stay, often results in corporations seeking protection of Chapter 11 to prolong the corporation’s business life, without there being any real possibility of the debtor corporation rehabilitating itself.¹²⁸⁰

¹²⁷⁶ For example, debtor corporations tend to forum shop in terms of state jurisdictions thought to be favourable to those in control of the corporation. T. Sullivan and J. Westbrook, “The Persistence of Local Legal Culture: twenty Years of Evidence from the Federal Bankruptcy Courts” (1994) 17 Harv. J. of Law and Social Policy 801 at 806.

¹²⁷⁷ Elizabeth Warren, Professor of Law, Harvard Law School, interview (1 March 1999).


practitioner recently reported that Chapter 11 cases take from 18 months to 7 years. \(^{1281}\) Under the U.S. scheme, the stay period creates a period of unaccountability because creditors cannot propose a reorganization plan. The U.S. regime has also been criticized for the growing phenomenon of multiple proceedings in which the same corporation returns to protection of the bankruptcy court for a second or third restructuring. \(^{1282}\)

As with Canada’s regime, the U.S. scheme provides for a process of disclosure, negotiation and then voting by class for a proposed plan. \(^{1283}\) The failure to devise a reorganization plan acceptable to creditors in required amounts of support will lead to bankruptcy and eventual liquidation on a going concern or asset basis. The court in sanctioning the plan must ensure that it meets the statutory requirements including the requisite amount of creditor support. The Code imposes an Absolute Priority Rule (APR) in which senior creditors, unless they agree to compromise their claims, must receive the full value of their claims in cash or equity before the claims of any junior creditors or interests are satisfied under the reorganization plan. \(^{1284}\) The counter-balance to this are the so-called “cram-down” provisions that are an exception to the APR. The court may approve a proposed plan over the objection of dissenting creditors, even key creditors, where it is satisfied that any creditor who has not accepted the plan will receive at least the amount it would have received on liquidation. \(^{1285}\) The cram-down provisions require that the plan provide for fair and equitable treatment for any dissenting creditor class and that it not discriminate unfairly with respect to treatment of those claims. \(^{1286}\) However, while the cram-down provisions are a key instrument that promotes rehabilitation, the

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\(^{1281}\) Rick Sierry, Counsel for Loewen Corporation, *Oral Submissions*, Case conference hearing, the Ontario Superior Court of Justice (Commercial List) (12 August 1999).

\(^{1282}\) Now often jokingly referred to as “chapter 22” and “chapter 33” proceedings.

\(^{1283}\) A creditors’ committee can be appointed to monitor the activities of the debtor. Warren and Westbrook, *supra*, note 151 at 399.

\(^{1284}\) Section 1129, *Bankruptcy Code*, *supra*, note 83.

\(^{1285}\) This is what Kordana and Posner call the “liquidation value floor” because it ensures creditors will receive at least the liquidation value of their claims. Kordana and Posner, *supra*, note 191 at 190.

\(^{1286}\) Markell, *supra*, note 1280 at 71.
provisions require the court to engage in costly and time consuming valuation proceedings before approving a plan. Under the cram-down rule, shareholders as the most junior claimants do not receive any value in the reorganized corporation unless creditors consent or all claims are paid in full. The only exception is where current owners contribute new value in terms of additional equity or credit, in which case they can retain the equivalent of that value without creditor consent.

Thus the policy objective of rehabilitation combined with these instruments, results in excessive delay in satisfying creditors’ claims under the U.S. regime, often without value enhancement in terms of continued operations. One solution has been pre-packaged plans for publicly traded companies where the proposed plan has already received support of key creditors and the process is expedited in terms of notice, conducting of votes and receipt of court sanction of the plan. The difficulty is that the initiative for this process must come from the debtor corporation. Those seeking merely to defer liquidation are unlikely to use this process. Similarly, the 1994 amendments to the Bankruptcy Code included a fast track procedure for small businesses and single asset companies. The problem is that it too is exclusively at the election of the DIP. Thus if the DIP wants to delay the proceedings, it can easily do so. In 1997, a National Bankruptcy Review Commission made more than 170 recommendations that aimed at reducing delay in the U.S. reorganization process, aimed particularly at small businesses unable to successfully re-organize under the Code. It advocated creating a mechanism to

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1287 Warren, supra, note 151 at 90.
1288 Section 1129, Bankruptcy Code, supra, note 83.
1289 Markell points out that this “new value exception” is not really an exception but the only value that is protected in the new value injected, as it would be with any new investor. Where it is beneficial is as a signal of the confidence of the shareholders in possible turn around given their willingness to risk new capital. Markell, supra, note 1280 at 111. See also Kordana and Posner, supra, note 191 at 195.
1290 Coffee and Klein, supra, note 114 at 1217, 1247.
1291 Frost, supra, note 202 at 127; Gross, supra, note 30 at 121.
encourage early identification of those corporations with no chance of success in order to terminate those proceedings earlier.\footnote{National Bankruptcy Review Commission, establish pursuant to Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. Ss. 601-610 (1997). The Commission also recommended that 1994 amendments recognizing future asbestos claims in bankruptcy be expanded to all unaccrued tort claims. It argued for a codified legal framework for all mass torts. This could include channeling injunctions to allow a "reasonably funded pool of resources" directed to mass future claim holders. DaRe, supra, note 1207 at 6.}

The U.S. experience suggests that public policy promoting the ability of debtor corporations to restructure their affairs needs to be accompanied by a scheme imposing tight timeframes, greater accountability and closer supervision of the activities of the debtor corporation. In the Canadian scheme, that accountability is created in a number of ways. First, the stay of proceedings under the CCAA is not automatic and courts occasionally have refused such applications if it appears that there is little or no chance of successfully restructuring its debts. Under both Canadian restructuring schemes, the initial stay period is short, and under the BIA, extensions of the stay can only be accomplished in 45-day periods to a total of six months. In contrast, the lengthy stay and periods of exclusivity under the U.S. regime can allow managers to deplete the assets available to satisfy stakeholder claims.\footnote{Block-Lieb, supra, note 127.} The U.S. experience also illustrates that the public policy objective of promoting rehabilitation does not in itself adequately balance the diverse interests of those with investments at risk in the corporation. An effective scheme must ensure that decision makers are accountable and that negotiations for restructuring take place in a timely manner such that those investments, including those of traditional creditors and other stakeholders, are not further jeopardized. Moreover, public policy endorsement of the value of restructuring does not necessarily mean that the value of the enterprise will be maximized.
ii. **Overview of Mexico's Scheme: Public Policy Recognition of the Value of Restructuring**

Mexico's restructuring regime is also one of rehabilitation, although the economic challenges faced by Mexico are radically different than those of the United States or Canada. For example, almost one half of Mexico's population is under age eighteen, resulting in more than a million new entrants into the workforce each year. Thus there is enormous pressure to create and sustain jobs. Moreover, the devaluation of Mexico's currency in 1994 created a financial crisis among debtor corporations that were highly leveraged based on foreign currency. The result has been a serious recession in which many corporations have become insolvent or bankrupt in large numbers for the first time in Mexico's commercial history. While the North American Free Trade Agreement (NAFTA) resulted in the growth of manufacturing in Mexico and initially increased employment, the financial problems persist, particularly in a period of increasing global competition for capital. The size of firms combined with their highly leveraged financial structure has resulted in more firms commercially failing.

Mexico has endorsed a strong public policy objective in favour of reorganization as a means of preserving jobs, going concern value, and what some scholars have referred to

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1294 Arturo Alcalde, Counsel, Asociación Nacional de Abogados Democráticos, Mexico, telephone interview (29 April 1999).


1296 Krawiec, *ibid.* at 481.

1297 Alcâde, *supra*, note 1294.

as "community values". Bankruptcy is considered harmful to the debtor corporation due to the loss of property, the uncertainty of creditors being able to recover their pro rata share of the assets, and harmful for the community due to the loss of jobs.

The governing legislation, the federal Ley de Quiebras y Suspensión de Pagos (LQSP), governs bankruptcy and reorganization in Mexico. The LQSP creates a regime in which a debtor corporation can be liquidated (quiebra) or undergo a process called a suspension of payments (suspensión de pagos) in which the corporation is given a period of time to develop a plan of compromise with creditors. The result of high levels of foreign currency debt and the devaluation of its currency is a recent proliferation of suspensión de pagos cases. An objective of the regime is to encourage continued operation of the business whenever its interruption may cause serious damage to creditors by decreasing the value of the assets available to satisfy their claims. Most proceedings, whether suspension de pagos or bankruptcy and liquidation, require two to five years to complete.

Access to the court-supervised restructuring regime is precipitated by "cessation of payments" to creditors, as opposed to a finding of insolvency. Martinez suggests that...

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1299 Statement of American Bankruptcy Law, supra, note 33 at 68. A Debtor in Reorganization is called a "Suspenso", at 153. The courts must also apply both federal laws aimed at particular institutions, such as federal laws on commerce and credit; Eduardo Martinez, "The Legal Effects of Suspension of Payments". paper presented to the Insol Bermuda Conference, April, 1999.


1301 Law of Bankruptcy and Suspension of Payments, Mexico, Art. 1. [Hereinafter the LQSP]. Mexico is a civil law regime and as a result is highly codified with less room for discretion of judges in development of the case law, Statement of Mexican Bankruptcy Law, supra, note 33 at 10 -13. Aimed at all acts of citizens that are engaged in commerce and have a profit motive (called comerciantes or merchants).

1302 Ibid. at 13.

1303 Ibid.

1304 Ibid. at 14.

1305 Ibid. at 18.

1306 LQSP, article 396, section V, called cesación de pagos.
while insolvency can be characterized as an economic status based on examination of the corporation’s financial records, cessation of payments for purposes of the LQSP involves one of three conditions: an economic state such as default on payments due or insufficient assets to secure payment of obligations due; cessation due to the conduct of the managers or owners of the corporation such as closing of the corporation’s premises, hiding, or absence without leaving a representative in charge of the affairs of the corporation; and cessation due to procedural acts such as the debtor’s request for a bankruptcy declaration or the failure to meet obligations in a suspensión de pagos.\(^1\)

Many of the requirements of the LQSP indicate its public policy objective supporting the value of workouts and rehabilitation. The legislation is aimed at preventing bankruptcy and facilitating the continuation of the corporation.\(^2\) The debtor corporation is given a period in which it can try to adjust its economic status through compromise or arrangements with creditors.\(^3\) Only a debtor corporation can file an application under suspensión de pagos and the courts are likely to give the corporation an opportunity to devise a plan, even where the creditors are seeking liquidation.\(^4\) The LQSP specifies that the debtor corporation must file the petition within three days of cessation of payments and before a declaration of liquidation.\(^5\) If the court is satisfied that the appropriate requirements have been met in terms of filing, including a “Preventive Plan” proposal to creditors, the stay is automatic.\(^6\) The stay does not however bind secured

\(^1\) Martinez, supra, note 1300 at 298-9.

\(^2\) Ibid. at 298.

\(^3\) Ibid. at 298.

\(^4\) LQSP, article 394, Statement, at 68.

\(^5\) American Law, supra, note 33, Statement, supra, note 1257 at 70. The cessation of payments, Cesación de Pagos, means that the merchant or debtor corporation has ceased payments to creditors, at 152.

\(^6\) All judicial proceedings to enforce or fulfill legal obligations are stayed except for the ones that seek assets that are not the property of the debtor, indebtedness due to workers or secured indebtedness. Martinez, supra, note 1300 at 299. The Preventive Plan is called a convenio preventivo, at 69. As in other jurisdictions, the stay is one of the most important provisions because traditional creditors cannot exercise remedies during the stay period. Occasionally, the court will approve a lift of the stay if the debtor
creditors. 1313 The debtor remains in control of the corporation during the period of negotiation and approval of the Plan by creditors. 1314 The Preventive Plan sets out a proposal for extension of time for making payments to creditors or reduction of the amount of debt owed, or both. 1315 The Plans rarely propose any restructuring beyond debt compromise, such as alterations to governance structure or ownership of the kind that frequently occur in Canadian restructuring. 1316 The LQSP sets out a creditors' notification and claim process, and meetings of creditors. Creditors can vote to accept, reject or amend the Preventive Plan at the creditors' meeting. As under the Canadian BIA, a vote by creditors rejecting the Plan results in automatic bankruptcy. 1317 Although the debtor corporation retains control during suspensión de pagos proceedings, a Sindicó exercises oversight. 1318 The Sindicó is similar to a trustee in a bankruptcy proceeding or a monitor under CCAA proceedings, depending on what part of the process the debtor corporation is in. 1319 The scheme also contemplates considerable court supervision. As in Canada, the directors of the corporation remain in control of daily operations and the administration of assets. Court approval is required for any decisions not part of routine operating decisions such as the sale of assets or part of the business operation. 1320

corporation and creditors have agreed to lift the stay for such purposes as obtaining financing or selling the firm on a going concern basis, at Statement, supra, note 1257 at 71.

1313 Martinez, supra, note 1300 at 6.

1314 Ibid. at 298.

1315 LQSP, supra, note 1299 at article 403.

1316 Alcade, supra, note 1294.

1317 Statement, supra, note 1297 at 70. Workers do not get a vote. While this makes sense in terms of their fixed claims which are satisfied in other forums, it in no way recognizes their human capital investment in the firm, as I argued in Chapter 2.

1318 Ibid. At 2, 14, 70, 71. The Sindicó is required to make operating reports to the court on a quarterly basis. Creditors may file petitions asking the court to convert the reorganization into a liquidation. The Sindicó as monitor must also approve the continuation and performance of exiting contracts, with the approval of the court, ensuring any securities or warranties are in place for creditors.

1319 Wilson, supra, note 696 at 52.

1320 Statement, supra, note 1297 at 71.
While the express policy of the Mexican federal government has been to support the value of *suspensión de pagos*, most cases have been unsuccessful and have ultimately resulted in liquidation, primarily because of the unwillingness of creditors to extend any further credit. Arturo Alcalde suggests that while public policy on paper favours the objective of rehabilitation, in practice, entry by corporations into *suspensión de pagos* is viewed as an early stage of ultimate liquidation. Public policy support for restructuring or compromise exists, but the court-supervised process is unwieldy, costly and lengthy, and does little other than to give debtors and workers prolonged notice in advance of liquidation of the assets.

In contrast, Alcalde reports that private workouts are common and often highly successful. This is because various stakeholders are willing to compromise their claims in exchange for ensuring the survival of the corporation. They avoid the costs, time delays and unwieldiness of the court-supervised process. For large corporations, the assets are so substantial that workers' fixed claims are insubstantial. In such cases, the survival of the corporation depends entirely on the traditional creditors and whether they want the liquidation value of the firm or are willing to privately workout a viable business plan. Unlike *suspensión de pagos* cases, private workouts tend to include changes to governance and production methods. Unions in particular have concluded that compromises of collective agreement provisions are preferable to the complete loss of jobs.

Thus it is evident from the Mexican experience that statements of public policy supporting restructuring do not necessarily translate into the existence of an effective regime. Moreover, the scheme, although characterized in the legislative language as

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1321 Ibid. at 14.
1322 Alcalde, supra, note 1294.
1323 Ibid.
1324 Ibid.
1325 Ibid.
providing for restructuring, is in fact directed strictly at compromising traditional
debt.1326 Given that traditional creditors in Canada often agree to compromises only if
they are persuaded that other changes are being made such that the corporation has a
reasonable chance of turning around its affairs, it is difficult to see what the incentives for
creditors are under the Mexican regime, other than perhaps a straight consideration of
liquidation value versus compromise value they can extract from a plan. It is worth
noting, however, that the existence of strong public policy supporting rehabilitation of the
corporation, even if ineffective, may act normatively to encourage the system of private
workouts that has arisen because of the threat that the court will intervene to ensure the
survival of the corporation.

iii. The Public Policy Objective of Workouts in France:
Early Intervention to Protect Stakeholder Interests

France’s regime is clearly situated as a rehabilitation regime. Insolvency and bankruptcy
legislation has as its express goal to encourage the prevention of bankruptcy and the
reorganization of debtor corporations’ debts.1327 The objective of the legislation is not
only to facilitate, but also actively to encourage reorganization of debtor corporations
experiencing financial difficulty.1328 The reorganizing mechanism is called a
redressement judiciaire. As with many jurisdictions, the stay provisions on enforcement

1326 Alcalde, supra, note 1294.
1327 Richard Koral and Marie-Christine Sordino, "The New Bankruptcy Reorganization Law in France:
Ten Years Later" (1996) 70 American Bankruptcy Law Journal 437. The same system is used for all
commercial reorganizations except for the smallest entities that have access to a simplified procedure, at
438.
1328 Ibid.
of claims during negotiations for a restructuring are automatic.\textsuperscript{1329} The unique feature of France's scheme is its focus on prevention of insolvency and on the role of the state through its court system of \textit{Tribunal de Commerce} in development and approval of restructuring plans.\textsuperscript{1330} Given that the current scheme has been in place for more than a decade, there are some useful lessons to be learned.

The strongest indicator of the regime's policy of encouraging workouts is the statutorily mandated goals of the legislation, which are to save the enterprise, preserve jobs and pay creditors claims. These objectives reflect broader French corporate governance policy that employee welfare and long-term strategic planning are objectives in addition to maximization of shareholder wealth.\textsuperscript{1331} The legislation and the resulting caselaw have specified that these objectives are to be taken into account in strict descending order of priority in the design and consideration of a \textit{redressement judiciaire}.\textsuperscript{1332} Thus the French legislation is even more explicit in its rehabilitation goals than the U.S. regime. There is a six-month period of observation under the court-appointed official before liquidation is permitted.\textsuperscript{1333} While this period is likely too long, it is noteworthy that the corporation enters the observation period much earlier in its financial distress.\textsuperscript{1334} At the end of the period, the official is able to make an informed judgment as to whether the corporation should be restructured or liquidated.\textsuperscript{1335} The 1986 legislation was amended to limit considerably the personal liability of managers of the corporation, to encourage

\textsuperscript{1329} Michelle White, "The Costs of Corporate Bankruptcy: A United States-European Comparison" in Bhandari and Weiss, \textit{supra}, note 6, 467 at 474.

\textsuperscript{1330} The most recent legislation that was enacted in 1985 and came into effect in 1986.

\textsuperscript{1331} Kissane, \textit{supra}, note 24 at 646.

\textsuperscript{1332} White, \textit{supra}, note 1327 at 442.

\textsuperscript{1333} \textit{Ibid.} at 473.

\textsuperscript{1334} See discussion, \textit{infra}, note 1360 on the preventive aspects of the scheme.

\textsuperscript{1335} The period of observation can last up to eighteen months, but requires court approval of these extensions. White, \textit{supra}, note 1327 at 475.
them to both enter the process earlier and to retain the skills of managers during the redressement period.\textsuperscript{1336}

\textit{Redressement} plans are considered, amended or approved by the \textit{Tribunal de Commerce}, which is the court charged with adjudicating under the legislation. There is a dual track system, the ordinary restructuring and a simplified procedure aimed at companies with an annual gross revenue of less than 20 million francs and fifty or fewer employees.\textsuperscript{1337} In the ordinary procedure, a court official called an \textit{administrateur judiciaire} is appointed. The duties of the \textit{administrateur judiciaire} range from monitoring the corporation, assisting existing managers, or actually taking over operating the business on a daily basis, depending on the circumstances.\textsuperscript{1338} The \textit{administrateur} represents the state rather than the creditors and thus can pursue the express objectives of the legislation with less conflict of interest with the creditors.\textsuperscript{1339} These officials are highly skilled in business decisions, financing, and turn around management expertise. Under the simplified procedure, the court may choose not to appoint an \textit{administrateur} thus avoiding additional administrative fees.

The duties of the \textit{administrateur judiciaire} resemble those of court-appointed officers in the Canadian regime, but entail a mix of duties resembling monitors, trustees and receivers. During the period of observation, the \textit{administrateur} studies the debtors’ business and develops a restructuring plan with the managers and other interests. Under the French scheme, the \textit{administrateur judiciaire} always develops the plan, including designing proposals for the scheduling and rate of repayment.\textsuperscript{1340} The \textit{administrateurs} report to the court on the financial position of the debtor corporation, future prospects,

\begin{footnotesize}
\begin{enumerate}
\item Prior to the 1986 law, directors were held personally liable for a portion of the corporation’s debt in over 80% of cases. Now the legislation specifies that they are personally liable where there has been mismanagement or fraud, White, \textit{supra}, note 1327 at 440.
\item \textit{Ibid.} at 449, 450.
\item White, \textit{supra}, note 1327 at 475-6.
\item Koral and Sordino, \textit{supra}, note 1327 at 450.
\end{enumerate}
\end{footnotesize}
the development of the plan and its specific proposals. The court places considerable reliance on the expertise and advice of its officers, not unlike the Canadian regime. The administrateur can also sell the business as a going concern and the process involves elements of a restructuring and a liquidation process. This is also viewed as complying with the legislative objectives of preserving an ongoing business and preserving jobs. Thus the system is less focused on who the ultimate owners of the corporation are and more on the preservation of the economic activity, or firm wealth maximization. The French regime demonstrates that for a rehabilitation objective to be effective, there need to be policy instruments available to ensure disclosure to creditors and other stakeholders, timely decision making and accountability of managers during the period that creditors' rights are stayed.

B. Enterprise Wealth Maximization as an Objective of Insolvency Law: A Comparative Analysis

Of the three rehabilitation regimes, the United States, Mexico and France, France is the only jurisdiction that appears to have shifted towards an enterprise wealth maximization model, the second systems component that I have advocated. In chapter 2, I suggested that an effective insolvency regime would include more express recognition of the objective of enterprise wealth maximization as opposed to shareholder or traditional creditor wealth maximization. This concept has not been endorsed in the United States insolvency regime, although there are a growing number of American scholars that

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1341 The initial period of observation can be up to six months, renewable for an additional 6 months then eight month period if necessary. Under the simplified procedure, the maximum period was lengthened from thirty days to four months in 1994 amendments to the legislation, renewable for a maximum of four additional months. Ibid. at 249, 250.

1342 Ibid. at 453.
propose this. Rather, the U. S. scheme aims at balancing shareholder rights with those of traditional creditors, the balance being clearly in favour of the debtor corporation.

Lin suggests that there are judicial precedents in the United States for endorsing enterprise wealth maximization. Where corporations are operating "in the vicinity of" insolvency, directors have been found to owe a duty not just to shareholders but to the corporate enterprise and an obligation to the community of interests that has sustained the corporation. Lin suggests, however, that this broad language is simply endorsement of existing contractual rights as opposed to recognition of a separate independent duty. McDaniel has observed that where trustees are appointed, they have been found to have a fiduciary obligation to treat all interested parties fairly, a duty of disclosure, and a duty to maximize the value of the assets. Thus, he argues that the fiduciary obligation of decision-makers in all reorganization proceedings should be recast to maximize firm value.

To date, however, this objective of enterprise value maximization has not received explicit endorsement by the courts. U.S. courts accord deference to continuation of the debtor corporation without adequately considering what interests comprise the enterprise and how wealth maximization is defined. Thus, rehabilitation is aimed at maximizing traditional creditor value only to the extent of the liquidation value of their claims, after which the paramount objective is the survival of the firm and preservation of any shareholder equity. This results in a scheme that does not particularly encourage enterprise wealth maximization.

Bruce Markell has suggested that in reorganization proceedings, given the increasing failure of firms in those sectors where there is not traditional security for credit, such as

1343 See for example Margaret Blair, supra, note 107.

1344 Ibid. at 1523, Credit Lyonnais Bank Nederland v. Pathe Communications Corp. (1991) Del. Ch. Lexis (108-9). In that case the Court held that directors have an obligation to exercise judgment in good faith, on an informed basis to maximize long term wealth creating capacity.

service, high tech industries, retail and supply chain financing, there is likely to be a shift in restructuring financing.\textsuperscript{1346} In such cases, Markell predicts a resurgence of workers, tax authorities and tort claimants as non-traditional creditors becoming the primary creditors in terms of reinvestment in insolvent firms.\textsuperscript{1347} If this occurs it may well encourage a move toward enterprise wealth maximization as a cost effective way to measure how one generates value for the “new investors”. However, to date, employee stock ownership plans (ESOPs) in the United States have not resulted in according stakeholders any governance rights.\textsuperscript{1348} Rather, these workers face the same contracting and collective action problems as shareholders of a widely held corporation.\textsuperscript{1349}

Under Mexico’s regime, there is no indication that the regime considers enterprise wealth maximization as a substantive goal. Plans under a suspensión de pagos support existing owners and the objective of trying to regain some equity value for them. Moreover, there does not appear to be an objective of enterprise wealth maximization in the system of private workouts that has evolved. Like the U.S., often the goal is survival of the business, without serious consideration of whether such survival will maximize the value to all of those with an interest in the corporation.\textsuperscript{1350}

Of the three rehabilitation models, France most closely resembles my notion of recasting the objective of insolvency law to one of firm wealth maximization instead of maximization of traditional creditor or shareholder wealth. Some scholars have suggested that the introduction of a more preventive and rehabilitation-oriented scheme in 1986 converted the French bankruptcy system from a legal regime to an economic


\textsuperscript{1347} Ibid. at 45. He suggests that if this occurs the current priorities for wages and taxes may need revisiting.

\textsuperscript{1348} O'Connor, supra, note 310 at 889-93.

\textsuperscript{1349} Van Wezel Stone, supra, note 291 at 367-71.

\textsuperscript{1350} Alcade, supra, note 1294.
one. This was accomplished in two ways. The first is the express recognition of the objectives of enterprise continuation, consideration of workers’ human capital investments and creditors’ claims, albeit in a strict hierarchy as noted above. Given the legislative direction to consider all of those interests, the Tribunal de Commerce and its court appointed officer the administrateur utilize the period of observation to devise a strategy to meet those objectives. The decision to restructure, sell on a going concern basis or liquidate the assets is then made having regard to how the value of the firm can be maximized. Ownership of the firm is less relevant than how to put the assets, including the value of workers’ human capital, to their best use.

Most interesting is that this is facilitated by the court-supervised process in which the economic and business decisions of the proposed redressement judiciaire are adjudicated on by businesspeople serving as judges. The Tribunal de Commerce is comprised entirely of business people, thus resembling somewhat Canada’s administrative tribunal system in which the adjudicators are not justices or lawyers, but rather are representative of the stakeholders at which the legislation is aimed. The Tribunal de Commerce has broad remedial powers as a court. The underlying assumption of the legislation is that business people will be the optimal decision-makers in terms of assessing the viability of any proposed restructuring plan. Thus business judgment is respected, but takes the form of court supervision by those with particular expertise. There is some question as to whether France has placed too much reliance on the court and its appointed officers, in its shift from a legal to an economic regime. However, given the court’s composition, many concerns often expressed in other regimes about the lack of business expertise of the judiciary are not relevant.

1351 Koral and Sordino, supra, note 1327 at 442.

1352 The judges are lay businesspeople elected by local chambers of commerce to sit in the court one or several days per week. Unlike North American chambers of commerce, in France, the Chamber of Commerce is a government organization that acts in a consular or liaison function with the business community. Ibid. at 443.

1353 The judges are assisted by staff lawyers, but are themselves business people.
The mandate of the *Tribunal de Commerce* also includes the ability to rework a proposed plan if practical experience dictates the necessity of this. Any decisions must be undertaken in accordance with the express objectives of saving the enterprise, preserving jobs and paying creditors.\(^{1354}\) The Court is empowered to approve a proposed plan of *redressement*, reject it, decide among competing proposed plans, or amend the plan to make it more commercially viable. The plans can include debtor in possession reorganization, or sale in whole or part of the business.\(^{1355}\)

Any assessment of the French insolvency system must be understood in the context of historically long periods of high unemployment and a long history of judicial and state intervention in commercial matters.\(^{1356}\) The legal system is a civil law regime, yet unlike much of the regime which is rule driven, the use of businesspeople as the court of jurisdiction means that decision-making has regard to economic considerations.

Although the regime may appear far removed from the North American approach to judicial decision making and judicial deference to business judgements, the deference manifests itself differently through how the court is structured.

Scholars suggest that the shift in France from a more debt collection regime to a rehabilitation regime in the 1980’s was precipitated by economic concerns that businesses should be given every opportunity to maximize value for the firm, within the context of an express objective of preserving where possible the employment of workers.\(^{1357}\) Thus, the shift is away from a strictly shareholder or traditional creditor value maximization model to one that has regard to broader economic concerns and the long-term viability of commercial enterprises. Encouraging restructuring is viewed as an indirect means of economic recovery.\(^{1358}\)

\(^{1354}\) *Ibid.* at 444.

\(^{1355}\) *La cession, la cession partielle, ibid.,* at 442.

\(^{1356}\) *Ibid.* at 444.

\(^{1357}\) *Ibid.* at 444.

\(^{1358}\) *Ibid.* at 453.
A major strength of this shift to a more enterprise wealth-generating regime is the objective under France's insolvency laws of early identification of corporate financial difficulty and thus preservation and enhancement of creditor value, and prevention of insolvency. Again, this must be understood in the context of a history of greater state intervention in the affairs of corporations. The regime requires extensive disclosure of financial affairs to state officials and other stakeholders.¹³⁵⁹ For example, the company's auditors must report directly to the board of directors when there is default on credit payments or other early warning signal of financial problems. The aim is to encourage officers and managers to respond quickly to possible financial difficulties.¹³⁶⁰ There is also mandatory disclosure of company financial reports and default in payments to the clerk of the Tribunal de Commerce.¹³⁶¹ The court monitors this disclosure and will initiate preventive action for companies that appear to be headed toward financial distress.¹³⁶² Usually it is default on payments or signals from creditors that the firm is not meeting payment obligations that signals to the Tribunal that intervention may be necessary, rather than broad monitoring of all corporations.

There are both informal and formal mechanisms to provide assistance to the debtor corporation. For example, the president of the Tribunal may summon a CEO for an informal discussion about the firm's financial affairs even before a restructuring proceeding is initiated. On the debtor corporation's consent, the court is empowered to order court-supervised mediation (règlement amiable), in which the debtor corporation negotiates with creditors through the use of a court-appointed mediator, to find an

¹³⁵⁹ Including outside auditors, boards of directors, supervisory boards that function like corporate boards of directors and workers' councils. Ibid. at 445.

¹³⁶⁰ Ibid. at 445.

¹³⁶¹ Ibid. at 446.

¹³⁶² Koral and Sordino report that the court identifies financial weakness through the use of fairly advanced computer analyses that identify indicia of trouble such as increased litigation, high turnover of managers, etc. Moreover, the auditor is required to report to the court if any default in payments is not cured in a timely manner. Ibid. at 446.
acceptable arrangement for meeting debt obligations.\textsuperscript{1363} This is undertaken either with key creditors or all creditors, frequently in advance of insolvency, and is undertaken under a rigorous secrecy requirement, the aim being to prevent the loss of corporate goodwill and customers.\textsuperscript{1364} During these negotiations, the court may impose a stay against creditor enforcement proceedings, on the recommendation of the mediator. The \textit{règlement amiable} is considered a critical component of the restructuring scheme because it provides a forum and breathing space in which creditors and the debtor can try to find an arrangement acceptable to all parties.\textsuperscript{1365} It resembles somewhat the court-supervised mediation process under the Canadian \textit{CCAA}, although the key difference appears to be that the intervention is much earlier and the mediation is conducted by businesspeople instead of lawyers or judges. The objective is to make the best use of business expertise, but to have expeditious access to the court if a consensual process does not succeed.\textsuperscript{1366}

The other notable feature of the French insolvency system is a triage hearing in which the court decides at the outset of any formal proceedings whether there is any hope of successful reorganization. If not, the corporation is streamed into liquidation proceedings and sold either on an asset or going concern basis. Thus while the debtor corporation, the creditors or the court itself can initiate a \textit{redressement} proceeding, the decision as to where the debtor will be streamed is determined at a hearing convened by the \textit{Tribunal de Commerce}.\textsuperscript{1367} Koral and Sordino report that studies undertaken of the first ten years of the law indicate that 92\% of all cases filed ended in liquidation, but that the vast majority of these were identified at the outset of the case through the triage hearing.\textsuperscript{1368} The early identification and elimination of firms with no chance of rehabilitation may be a measure

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\item This is referred to as \textit{règlement amiable} (translated literally means: "friendly settlement"). \textit{Ibid.} at 446.
\item This secrecy requirement is enforced by criminal sanctions and can last for three months, subject to extension. \textit{Ibid.} at 446.
\item \textit{Ibid.} at 446.
\item \textit{Ibid.}
\item \textit{Ibid.} at 448.
\item \textit{Ibid.} at 448.
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of success of the system because value to creditors in not unnecessarily depleted during a lengthy proceeding.

Thus, the French regime works to resolve problems before the corporation enters into a *redressement* proceeding, and failing that resolution works to identify only those firms with a chance of survival. It is then these firms that are permitted to restructure their affairs through the *redressement judiciare* process. The objective of enterprise value maximization results in a regime with a preventive triage and restructuring options that take account of numerous investments in the firm. Unfortunately, the French scheme does not have comprehensive empirical data to measure the outcomes against the explicit objectives of the statute.

C. Recognition of Workers' and Other Stakeholders' Equitable Investments in the Firm During the Restructuring Process

In the three jurisdictions discussed, there is a paucity of information on the recognition of non-traditional stakeholders other than workers. The United States has recognized tort claimants as contingent creditors in terms of negotiations for a workout of claims and voting on a plan.\(^{1369}\) Rights to participate in reorganization proceedings have generally been accorded only to those with capital claims. Reference to communities or other non-traditional stakeholders appears in the caselaw only indirectly in terms of the overall rehabilitation goals of the regime, or in terms of the need to balance environmental law with bankruptcy law.\(^{1370}\) Broader stakeholder or public interests are considered only in

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\(^{1370}\) For a discussion of the conflicts of the DIP under environmental and bankruptcy laws and the courts' attempts to balance these, see Stanley Spracker and James Barnette, "The Treatment of Environmental Matters in Bankruptcy Cases" (1995) 11 Bank. Dev. J. 85 at 91, 126. Generally, the need for “fresh start” may trump in terms of meeting environmental obligations. Debtors generally try to address and discharge
the context of the rationale for a strong orientation towards rehabilitation of the corporation. For comparative purposes, therefore, the most available information is with respect to workers and how their human capital investments are recognized in insolvency law. Here the three rehabilitation schemes vary considerably.

i. **Stakeholder Interests in the United States:**

**Workers, Unions and Section 1113 of the U. S. Bankruptcy Code**

American bankruptcy caselaw and congressional debates on the *U. S. Bankruptcy Code* include many references to concerns about the impact of bankruptcy on workers and communities. Franks and Torous suggest that the U. S. regime indirectly gives considerable weight to stakeholders such as communities through incentives to keep the firm operating and through judicial encouragement of reorganization. They suggest that part of the justification for the debtor orientation of the scheme is because of the large numbers of employees and local suppliers who are usually not part of the decision to liquidate; thus the focus on survival indirectly represents their interests. With respect to the railways, historically there were special provisions in American bankruptcy law requiring that the court take into account the public interest before sanctioning a reorganization plan, and requiring that any approved plan be consistent with the "public interest". This was because of the vital nature of rail transportation in linking the

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1372 Franks and Torous, *supra*, note 199 at 463. They suggest that this gives a competitive advantage of the reorganized firm over other firms in the same industry and that the costs are merely shifted.

economic and social activity of the country and the public interest in preserving uninterrupted service. Julie Veach has suggested that this historical language should be imported generally into the U.S. Bankruptcy Code and that this would offer a procedural mechanism by which the voices of parties with an interest in the debtor corporation, such as workers and communities could be heard. In assessing the "public interest" in railway cases, the courts did not consider that such interests would trump, but rather, the public interest was one factor among many considerations that the courts took into account.

The objective of job preservation is often cited as a key reason for allowing American based debtor corporations the opportunity to develop plans of reorganization. Yet there are several important observations. First, recognition of the value of preserving job rights has rarely translated into participation or decision rights as I have suggested in chapter 2. The exception may be where workers actually purchase the insolvent company, although this is often a share purchase without according workers any governance role in the corporation. Second, while the extended period that the corporation can remain under the protection of the court means that jobs are preserved for that period, the ultimate failure of the majority of applications results in those interests not necessarily being protected. Under Chapter 11, workers often continue their human capital investments, thereby increasing the amount of investment at risk when the firm ultimately becomes bankrupt. This is often exacerbated by the further investment of human capital through wage concessions, reduced pension and employee welfare benefits.

1374 See: Re Chicago, Milwaukee, St. Paul & Pacific Railway Company 830 F. 2d 758 (7th Cir.) (1989); Palmer v. Mass, 308 U.S.79 (1939); Re Delaware and Hudson Ry. Company 124 B. R. 169 (D. Del. 1991); Re Boston and Main Corp. 719 F. 2d 493 (1st Cir. 1983).


1376 Ibid. She proposes a statutory amendment that allows but does not require bankruptcy courts to consider the public interest in business reorganizations.

1377 Ibid.

1378 O'Connor, supra, note 310 at 899.

1379 Blair, supra, note 107 and 107.
Workers continue to make firm specific undiversified investments that are then lost when the firm is ultimately liquidated. Often they have not used the period of further investment to secure alternative employment because of information asymmetries and firm loyalty, the latter being a further indicator of their residual or equitable interest.\footnote{1380}{Justice Jones of the 5\textsuperscript{th} Circuit U.S.C.A. has observed that the suggestion that Chapter 11 provides workers with relief is largely illusory, because they stay and contribute their human capital and yet most businesses fail afterwards, supra, note 1263 at 1090.}

As noted in chapter 3, under the Canadian regime, a restructured corporation is bound to any collective agreements in place prior to the restructuring. This includes new purchasers who are bound under the successor rights provisions of provincial and federal labour relations statutes. Thus the Canadian statutory scheme protects the capital claims of workers under collective agreements. Practically speaking, however, unions frequently bargain for compromise of their claims under collective agreements because this better protects workers' investments in the firm and is preferable to bankruptcy and termination of employment. The Canadian insolvency regime does not include as one of its policy instruments the repudiation of collective agreements.

In contrast, the U.S. scheme does allow for repudiation of collective agreements, if certain conditions are met. This works to minimize the protection afforded by similar successor rights protection in U.S. labour law. However, in the context of U.S. bankruptcy law, it is considered special treatment within the Code's broader scheme regarding the repudiation of executory contracts.\footnote{1381}{Executory contracts are defined as contracts that have mixed assets and liabilities and for which there are still obligations to be performed by the parties. Jackson, supra, note 129 at 106.} Section 1113 of the U.S. Bankruptcy Code, which deals with the repudiation of collective agreements, was enacted in response to the United States Supreme Court decision in NLRB v. Bildisco, in which the Court held that collective agreements are executory contracts within the meaning of the Bankruptcy Code.\footnote{1382}{Re NLRB v. Bildisco and Bildisco 465 U.S. 513 (1984). 104 S. Ct. 1188 (1984).} The Court in Bildisco upheld the right of a debtor corporation to reject a collective agreement and to unilaterally implement changes in terms and
conditions of work without violating the *National Labour Relations Act*. As a result of public outcry after the *Bildisco* judgment, the *Bankruptcy Code* was amended to include section 1113, which now governs the rejection of collective agreements under Chapter 11 proceedings. Section 1113 departs from the business judgement standard and recognizes the special nature of collective agreements under parallel labour laws governing the negotiation and administration of collective agreements. The provision is viewed as a compromise between bankruptcy reorganization principles and labour law principles.

Section 1113 specifies both procedural and substantive conditions that the debtor corporation must meet before the Court will uphold its rejection of a collective agreement. In terms of the procedural requirements, the debtor’s proposal to the union must be based on the most complete information available at the time of the proposal; the corporation must provide to the union “such relevant information as is necessary to evaluate the proposal”, and the debtor must meet at reasonable times and confer in good faith with the union in an effort to reach an agreement on modifications to the collective

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1383 The *National Labour Relations Board* (NLRB) had found that the company committed unfair labour practices when the company failed to negotiate or to pay wages, benefits and remit dues required under the agreement. The Supreme Court held that unexpired collective agreements were executory contracts within the meaning of the *Bankruptcy Code* and thus, subject to the court’s approval, they can be rejected. While the rights of workers under collective agreements are important, the equitable nature of the Bankruptcy Court requires a balancing of the equities in any given case. The Court imposed a test which it held was higher than the business judgement rule, in which the debtor company must demonstrate that the “collective agreement burdens the estate”, and that after careful scrutiny, the equities balance in favour of rejecting the labour contract. The debtor must also make reasonable efforts to negotiate a voluntary modification. The exercise of the courts discretion should be made in the context of the policy goals of Chapter 11 which are to permit successful rehabilitation of debtors, and thus, the court should undertake a balancing of the interests and potential hardship faced by the debtors, creditors and employees. The NLRB was precluded from enforcing the terms of a collective agreement or finding a violation of the *NLRA* because the filing of a petition under Chapter 11 means that the Collective Agreement is no longer immediately enforceable.


1385 *National Labour Relations Act* (NLRA), supra, note 1121.

agreement.\textsuperscript{1387} The three substantive requirements are that the debtor has satisfied the above specified information requirements; that the union has refused to accept the proposed modifications "without good cause"; and that the balance of equities favours rejection of the collective agreement.\textsuperscript{1388} The objective of section 1113 was to allow the debtor corporation to reject a collective agreement and thus control labour costs in developing a reorganization plan.\textsuperscript{1389}

Interestingly, the language and purpose of Section 1113 was intended to recognize the special nature of workers' investments in the firm and at the same time allow the debtor corporation and ultimately the court to balance all of the economic interests in development of the plan.\textsuperscript{1390} These notions are very similar to my ideas in chapter 2. In the context of a scheme that is extremely debtor oriented and allows for the repudiation of executory contracts, this is a benefit for workers, and a means of allowing them some opportunity to bargain the changes. In the context of a more creditor oriented scheme, the provisions work to diminish even the fixed capital claims of workers. The U.S. courts have failed completely to reach consensus on the tests to be applied. The courts have varied between a "functional" approach to section 1113, described below, and a "nine-part test".\textsuperscript{1391} The nine-part test includes a requirement that the modifications to the collective agreement are necessary to permit the reorganization of the debtor corporation. However, "necessary to the reorganization" has been interpreted in different ways by the

\textsuperscript{1387}Section 1113(b)(1)(2), and Bankruptcy Code, supra, note 83.
\textsuperscript{1388}Section 1113(c)(1), ibid.
\textsuperscript{1389}Cuevas, infra, note 1402 at 224.
\textsuperscript{1390}Ibid.
\textsuperscript{1391}Re American Provision Co. 44 B.R. 907 (Bank. D. Minn. 1984); see also Re Salt Creek, supra, note x; Re Valley Steel Prods. Co. 142 B.R. 337 (Bank. E.D. Mo. 1992). The nine-part test includes consideration of such factors as: the debtor must make a proposal to amend the collective agreement based on the most complete information available at the time; the proposed modifications must be necessary to permit the reorganization of the debtor corporation; the modifications are to treat the debtor, creditors and other affected parties fairly and equitably; the debtor must have provided the union with the relevant information necessary to evaluate the proposal; the debtor must have met with the union at reasonable times between making the proposal and seeking the approval of the court in a good faith attempt to reach a mutually satisfactory modification; the union must have refused the modifications without good cause; and the balance of equities clearly favour rejection of the collective agreement.
courts, to mean either "only those modifications the company or trustee is constrained to accept because they relate directly to the company's financial condition and reorganization", or a less rigorous approach in which the courts have held that necessary does not mean minimal or essential changes. The uneven approach by the courts has encouraged forum shopping by debtor corporations as a means of avoiding obligations to workers. Given that the firm does not have to be insolvent to take advantage of Chapter 11 proceedings, it also creates incentive for financially troubled corporations to enter reorganization proceedings just to repudiate expensive labour contracts.

More recently some courts have adopted a "functional approach" to applications to repudiate collective agreements, having closer regard to the language of section 1113. In Re Maxwell Newspapers Inc., the Second Circuit Court of Appeals held that the debtor corporation must show that its pre-rejection proposal was made in good faith and contains necessary but not absolutely minimal changes that will enable the debtor corporation to successfully reorganize. The court defined "good cause" as meaning that a union can reject a proposal if its members are being unfairly burdened relative to other parties or if the proposal is not necessary to the debtor corporation's reorganization. Other than for these reasons, the union cannot turn down the proposal if it has not proffered an alternative that accomplishes the same economic ends in terms

1392 Wheeling-Pittsburgh Steel Corporation v. United Steelworkers of America, 791 F. 2d 1074 (3d Cir. 1988).

1393 Sheet Metal Workers International Association v. Mile Hi Metal Sys. Inc. 899 F. 2d 887 (10th Cir. 1990), focusing on successful reorganization.

1394 Cuevas, infra, note 1402 at 190, 198.

1395 Warren and Westbrook, supra, note 151 at 115.

1396 Re Maxwell Newspapers Inc. (MNI), 981 F. 2d Cir. (1992) at 89. See also Re Royal Composing Room Inc. 848 F. 2d at 343 (2d Cir. 1988), cert. Denied 489 U.S. 1078 (1989). These changes are not subject to a test that they be the absolute minimal changes, thus granting corporations considerable latitude. It held that rejection of a collective agreement is permitted only if the debtor fulfills the information requirements, the union lacks good cause to reject the proposal, and the balance of equities clearly favours the rejection.

1397 Ibid. at 932, citing Carey Transport v. Teamsters 816 F. 2d 82 (2d Cir. 1987).
of meeting the needs of the reorganization.1398 In another case, *Re Salt Creek Freightways*, good cause was interpreted to mean that the union must consider the economic needs of the corporation in reorganizing.1399 However, in *Salt Creek*, although the company and union had just commenced negotiations, the court granted immediate interim relief because the company was at risk of going out of business and it allowed the company to unilaterally reduce wage rates and eliminate benefits payments.1400

Although the language of the U.S. courts have been one of balancing the equities, the reality is that a debtor company can unilaterally reject the collective agreement.1401 The requirement that unions must consider the economic needs of the corporation foremost appears to neglect the fact that unions have negotiated collective agreement language over many years in recognition of human capital investments. It also fails to recognize that unions have a fiduciary obligation to their members.

While labour costs are an important issue facing reorganizing corporations, the section 1113 caselaw has spawned considerable debate and criticism from scholars and practitioners.1402 Some practitioners argue for a form of final offer arbitration as the

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1398 In *MN.* the union had bargained for strong job security language in exchange for consent to major technological change. *Ibid.* The courts have also held that section 1113 applies where the debtor corporation tried to reorganize through sale of its business, thus even where there is a sale of assets, the corporation and successor may be able to repudiate the contract. M. Kirschner, W. Goldsmith, L. Gottesman, D. Jenab and J. Swardenski, *"Tossing the Coin under Section 1113: Heads or Tails, the Union Wins"* (1993) 23 Seaton Hall Law Review 1516 at 1526.

1399 46 Bankr. R. 347 (Bankr. D. Wyo. 1985). The court held that section 1113 required the debtor to have met and conferred in good faith with the union over the debtor’s proposed "modifications". During this period, the length not being specified, the collective agreement remains in effect.

1400 It eliminated payments to the health, welfare and pension funds, eliminated sick leave payments, and reduced paid vacation. The court ordered these changes for a two-month period or until the parties negotiated a new collective agreement.


instrument for amending collective agreements during a reorganization proceeding.\textsuperscript{1403} This would reduce opportunistic behaviour by parties in negotiating modified agreements.

Thus while the language is one of consideration of workers' interests, in reality human capital investments are recognized only indirectly through section 1113 requirements in unionized workplaces. Collective agreements fare only marginally better than executory contracts.\textsuperscript{1404} The ability of the debtor corporation to reject the collective agreement creates additional litigation and adversarial relations between workers, unions and corporations. This in turn reduces the likelihood that they can reconcile their diverse interests without intervention of the court, which in turn creates delay and adds considerable transaction costs to the reorganization process. Moreover, given that the union's resources must be directed to defending existing agreements, they are less likely to focus on an effective governance strategy to assist the corporation in turning around its financial affairs. Warren observes that the section 1113 provisions have not been used by unions to bargain for any governance change.\textsuperscript{1405}

It seems evident that unions in the United States are unlikely to be accorded participation rights such as those suggested in chapter 2. This experience differs from recent developments in Canada in which creditors and the courts have been willing to involve unions in the restructuring process. The only positive development in U. S. caselaw is that courts have held that where a union makes a compromise proposal that meets its needs while creating savings for the debtor, the court will find that the union had good

\textsuperscript{1403} Kirschner, supra, note 1398 at 1544. This would include a short bargaining period; exchange of detailed proposals and expeditious arbitration by the bankruptcy court if the parties failed to agree. A requirement that the court select one offer or the other would force parties to be reasonable in their demands.

\textsuperscript{1404} McClain, supra, note 1399 at 191-193.

\textsuperscript{1405} Elizabeth Warren, interview (Cambridge) (1 March 1999).
cause to reject the proposed repudiation. However, these participation rights are essentially negative rights. Unions are permitted to defend the gains that they have bargained for previously only if they can craft proposals that generate the same kind of savings to the debtor corporation. Interestingly, the U.S. courts have held that once a corporation becomes insolvent, creditors' interest become an "equitable interest" in the assets of the corporation such that a fiduciary duty arises. While this finding of equitable interest was not a finding with respect to workers, the Court's recognition of a notion of equitable interest once the firm is insolvent, may be an avenue that workers and unions could pursue in the future if they wanted to seek participation and decision rights of the type suggested in chapter 2.

ii. Mexico: the Gap Between State Controlled Unions and the Participation Rights of Workers

In Mexico, the rhetoric of public policy recognizes the investments of workers and community, but it is fairly evident that practices do not reflect this. It is important to understand the context of organized labour in Mexico, in order to understand why the scheme does not afford workers participation rights. Since the Mexican revolution, the government has operated under a single party system ostensibly representing the tri-partite interests of the state, employers and unions. Over the past seventy years, however, the interests of these unions have almost entirely converged with that of the state and business. Thus while unions officially have input, they have not necessarily

1406 Royal Composing, supra, note 526 at 348; MRI 981 f. 2d 85 (2d. Cir. 1992) at 90, 92. However, the fact that the union has agreed to cut may not be sufficient to defeat a repudiation application, In Re Valley Steel Prod. Co. 142 B.R. 337 (Bankr. E. D. Mo. 1992) at 342.


1408 Alcade, supra, note 1294.
reflected the interests and investments of workers. There is considerable corruption, very poor working standards, prohibitions on workers forming independent unions, and none of the democratic features that unions in Canada expect. Moreover, employment standards have been lowered both from the export processing exemptions of the 1960's and more recent trade liberalization agreements.

It is against this backdrop that one must examine whether the equitable investments of workers and other stakeholders are part of the governance debate. Mexican labour laws were originally enacted to provide protection to workers and to accord them a decision-making role in both corporations and government. Strong just cause and job security language are set out in statutes but are not in any way a reality. For example, Alcalde suggests that when a small or medium enterprise enters suspensión de pagos, often the company pays off the union leadership directly in an informal compromise, and workers, creditors and local governments do not receive the benefits of the law. The unions consider themselves businesses and consider what deals can be arranged with the insolvent firm. Often those arrangements ignore the legitimate interests of creditors, governments and the workers themselves who are the actual creditors.

The Transnational Insolvency Project studying Mexican Bankruptcy Law has noted that one of the most crucial elements in the operation of the debtor corporation during the reorganization process is the relationship of the company with its workers, particularly in

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1409 Ibid.

1410 Although under NAFTA Side-Agreements, each country is supposed to enforce effectively its labour standards. Ibid.

1411 Ibid.

1412 Ibid. Over 90% of Mexican Unions are state controlled unions. Membership in trade unions is based on the collective agreement and often companies seek out the unions and agree on a contract without workers even knowing that they have a union or a collective agreement. Thus unions are complicit in helping companies to avoid their obligations in insolvency proceedings, often to the detriment of the interests of the workers and other creditors.

1413 Ibid. Where the union is corrupt, the payouts actually go directly to union leaders instead of the workers who have the fixed capital claims.
cases where they are unionized. Co-operation between workers and managers in the organization can apparently be a powerful tool to pressure creditors to grant more favourable credit terms. Apparently this is because of the value of good labour relations with few production disruptions. Other practitioners disagree. Arturo Alcalde, a Mexican practitioner, argues that any bargaining power that the union may have derives from any first claim that it may have on the assets of the corporation if it were liquidated. However, given the high unemployment rate, unions are willing to negotiate and severely compromise their claims because the alternative of unemployment is a much greater harm. Further, given the amount of corruption, the deals made between state-sponsored unions and companies can work to the detriment of all stakeholders because it prevents negotiations for a viable business plan that will facilitate the successful turnaround of the corporation.

One important observation is that the satisfaction of workers' fixed claims is at the top of statutory preferences. Moreover, claims for wages owed to workers are not stayed under the stay provisions of the LQSP and workers can try to enforce those claims. Labour matters in Mexico fall largely outside the jurisdiction of the bankruptcy court. Fixed wage and benefit claims are dealt with by tri-partite Conciliation and Arbitration Boards called Juntas de Conciliación y Arbitraje, ("JCA"), whose awards are final and binding. The orders of the JCA are binding on the bankruptcy court, including orders to sell assets to satisfy wage claims. Another statutory exception to the stay provisions are employment contracts, both individual and collective, which are terminated if the

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1414 Ibid. at 71.

1415 Ibid. at 72.

1416 Alcalde, supra, note 1294.

1417 Alcalde reports for example, that sometime companies sell the assets on a liquidate basis to the union and then repurchase them at a discounted value after bankruptcy proceedings are complete and the courts have "purified" the corporation's debts. Ibid.

1418 Ibid.

1419 Martinez, supra, note 1299 at 5.
bankruptcy court or creditors decide to close down the operation or reduce the workforce.\footnote{Statement on Mexican Bankruptcy Law, supra, note 1297 at 33.} Often however, there is an overlap between the bankruptcy court and the labour tribunal, adding both transaction costs and confusion to the proceedings. The American Law Institute suggests that it is the ability to enforce workers' fixed claims during the stay period that gives unions bargaining power in any plan workout.\footnote{Ibid. at 33, 36. Identification of assets in the bankruptcy process (la masa) includes active (assets) and passive (liabilities), at 36.}

Although the \textit{LQSP} is aimed ostensibly at "community values", in reality those values translate into a highly debtor-oriented regime in which the survival of the corporation is paramount. The compromise made, whether in or out of \textit{suspensión de pagos} proceedings, usually accrues almost exclusively to the benefit of the owners of the corporation, often leaving unsecured creditors, including local governments, with no payout.\footnote{American Law Institute, supra, note 33 at 72.} In turn, this means that there is no local revenue available to assist workers in the adjustment costs resulting from firm failure.\footnote{Alcalde, supra, note 1294.}

iii. \textit{The Recognition of the Human Capital Investments of French Workers}

The recognition of human capital investments in French insolvency law is facilitated by the express statutory language that has job preservation as an important objective. French law adopts a variety of instruments for protecting workers' interests. For example, France has established a national wage earner protection fund as the optimal means of protecting
employees from insolvency.\textsuperscript{1425} Thus the recognition given to workers’ interests in the restructuring scheme is a complement to other policy tools aimed at minimizing harm to workers from firm failure.

In terms of France’s restructuring scheme, the role of workers, which prior to 1986 was that of ordinary creditors, has been enhanced. Worker representatives as well as creditors can initiate bankruptcy proceedings, and once initiated, the onus falls on the directors of the debtor corporation to demonstrate that the firm is not insolvent.\textsuperscript{1426} A representative of labour is appointed by the court to be heard on substantive issues regarding the reorganization of the corporation. The labour council in the workplace selects the workers’ representative.\textsuperscript{1427} Moreover, even in advance of entering formal restructuring proceedings, corporations are required to disclose financial statements and forecasts to workers’ councils.\textsuperscript{1428} Workers are given voice and participation rights and their advice forms part of the decision-making of courts and their appointed officers in terms of the decision whether to restructure or liquidate the firm.\textsuperscript{1429} This not only addresses some of the problems of information asymmetries noted in chapter 2, but also allows workers’ councils to use their informational capital to contribute to the governance of the corporation.

Moreover, under the French scheme, if there is more than one proposed commercially viable redressement and one preserves jobs whereas the other provides for the greater payout of creditors’ claims, the court is required to choose the former because of the higher public policy recognition given to preserving jobs.\textsuperscript{1430} Thus, the scheme aims first

\textsuperscript{1425} Ziegel and Cuming, supra, note 2 at 734.

\textsuperscript{1426} White, supra, note 184 at 469.

\textsuperscript{1427} Koral and Sordino, supra, note 1327 at 441, 445. Workers’ councils are required for all firms with a specified number of employees. Members of the workers’ council are entitled to attend board of director meetings. If there is no workers’ council, the representative is elected by employees by secret ballot.

\textsuperscript{1428} Called les comités d’entreprise, ibid., at 445.

\textsuperscript{1429} White, supra, note 184 at 471.

\textsuperscript{1430} Ibid. at 444.
at ensuring that plans are commercially viable, utilizing the business expertise of the court. Second, within those possibilities, it creates a hierarchy of interests to be considered, with workers’ jobs ranking higher than the satisfaction of traditional creditors’ claims. This reflects a public policy view that traditional creditors can bargain a risk premium and workers generally can not.1431

Court-appointed officers play a key role in the successful consideration of stakeholder interests and mediation of a negotiated resolution to the firm’s financial distress. The administrateur in the redressement proceeding or the mediator in the règlement amiable use their business expertise and are key to making a frank assessment of the debtor corporation’s prospects. They ensure that a greater role is given to creditors and workers in assessing and influencing the design of a viable plan.1432 Part of the mandate of the administrateur is to consider the needs of workers and the interests of community. Thus, its role in facilitating a negotiated resolution also involves ensuring that those interests are expressly accounted for in the workout.1433

D. Reconciling the Rights of Traditional Creditors with Other Stakeholder Interests

Generally one might assume that a rehabilitation regime ignores the interests of creditors. This is far too simplistic an analysis, not only because of the very diverse interests of creditors, which I described in chapter 2, but also because restructuring regimes can advance the interests of creditors as well as debtors.

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1431 Koral and Sordina, supra, note 1327 at 457.
1432 Ibid.
1433 Ibid.
For example, in the United States, secured creditors' interests are protected by the absolute priority rule (APR), which requires that each class of creditors be paid in full in cash or securities prior to the receipt or retention by any junior class of creditors or shareholders of any property or interest in the reorganized enterprise. Thus while secured creditors can negotiate less than this value in the plan, they are not required to do so. In turn, this encourages the debtor corporation to develop proposals that creditors will endorse. Absent a negotiated settlement, the court will not sanction a plan that does not comply with the APR.

The counter-balance to these traditional creditors' rights is the existence of the "cram-down" provisions which are available only to the party proposing the plan, usually the debtor corporation because of the prolonged exclusivity period. In such cases, the court may sanction a plan over the objection of dissenting creditors if the court is persuaded that the plan does not discriminate unfairly, and is fair and equitable with respect to any interest impaired that has not accepted the plan. To determine this, the court determines the value of the interest in order to satisfy itself that the dissenting creditor has received at least what it would have received in liquidation. The cram-down provisions can benefit the debtor corporation because it ensures that the plan will not be defeated solely because a key creditor has not endorsed the plan. However, it also can benefit dissenting creditors in that their liquidation value interests are secured and because of the statutory prohibition against unfair or discriminatory treatment. Baird and Jackson note, however, that the APR creates incentives for managers and senior creditors to squeeze out lower priority creditors in the reorganization.

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1434 Section 1129(b), Bankruptcy Code, supra note 83; Miller, supra, note 1405 at 1492.

1435 Section 1129(b), ibid.


1437 Douglas Baird and Thomas Jackson, "Bargaining after the Fall and the Contours of the Absolute Priority Rule" (1988) 55 U. Chi. L. Rev. 738 at 738-40. Bebchuk and Fried have observed that the APR causes excessive use of secured interests, thus distorting the monitoring arrangements of creditors and reducing the incentive of firms to undertake adequate risk assessment. L. Bebchuk and J. Fried, "The
The APR assists considerably in protecting traditional creditor rights by ensuring that any proposed reorganization plan does not unduly disadvantage creditors. However, at the point of insolvency, creditors' claims are particularly time sensitive and the process of valuing these claims means that value accruing to creditors can be seriously diminished during the period that parties contest valuation. This combined with the delays inherent in the stay process can work to seriously compromise creditors' claims. As a result, if the parties can negotiate a re-organization plan in a reasonably timely way, creditors will compromise their claims to preserve and receive as much value as possible.

Several studies have found that most Chapter 11 reorganizations provide for slight variations from the APR in favour of shareholders and some creditors.

Second, creditor interests under the U.S. scheme are somewhat protected because once the corporation becomes insolvent, the directors of the debtor corporation have a fiduciary duty to the creditors. This fiduciary duty arises when the corporation is in the "vicinity of insolvency" and while the scope of that duty has not yet been clearly defined in terms of whether creditor value should be maximized, directors are prohibited from decision-making that benefits managers, shareholders or preferred creditors to the detriment of other traditional creditors. Lin suggests that the U.S. courts have not expanded the scope of fiduciary duty to creditors, but rather have rendered judgments that either address breaches of the contractual obligations of parties under the language of fiduciary obligation or that find culpable behaviour in the form of fraudulent preferences.


Markell, supra, note 1280 at 118.


Lin, supra, note 23 at 1512.

or illegal diversion of assets. This differs from the notion that directors are to undertake decision-making with a view to maximizing the return to creditors. However, in *Credit Lyonnais Bank Nederland*, the Court held that directors of a corporation in the vicinity of insolvency should view the corporation as a “community of interests” and undertake business decision-making to maximize the value of the estate having regard to that entire community of interests. This indicates some willingness by the courts to require directors to act in a manner that is a reasoned effort to balance all of the competing interests, including creditors and equity owners as a collective group. The issue is whether the courts will expand these notions to require directors to take account of interests of non-traditional creditors, as I suggest in chapter 2.

Another issue that concerns American scholars is that if a creditor has exercised control over an insolvent corporation and has engaged in inequitable conduct, the court can subordinate its claims to those of other creditors. Yet where creditors do not assume some control, the directors are ostensibly fiduciaries of the DIP under Chapter 11. The directors have a fiduciary obligation to both shareholders and creditors, the rationale for the fiduciary obligation being that this is the *quid pro quo* for creditors having the right to enforce their claims temporarily suspended. Practically speaking, however, directors are still elected and accountable to the shareholders. Since the courts continue to exercise considerable deference to business judgments, this can work to undermine the interests of

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1442 The fraudulent preference type behaviour most often occurs in closely held corporations where directors tend also to be major shareholders, Lin, *supra*, note 23 at 1513, 1518, 1521 and the cases cited therein. See also Miller, *supra*, note 1405 at 1485.


1445 Inequitable conduct would include conduct that creates an unfair advantage for the creditor or harm to other creditors’ interests. Lin, *supra*, note 23 at 1504-5, citing s. 510 of the *Bankruptcy Code*.

1446 Chou, *supra*, note 1259 at 578. The courts are however still divided on whether the fiduciary obligation is solely to creditors or to shareholders and creditors; Miller, *supra*, note 1405 at 1482.
Directors have an inherent conflict in that they are bargaining on behalf of the shareholders with creditors for a workout, yet they also have an obligation to creditors. In the United States, widely held credit creates serious collective action problems for creditors in terms of monitoring. Unlike Canada, only a small minority of reorganization proceedings have creditors' committees. Although trustees are only rarely appointed to take over operations during reorganization proceedings, increasing use is being made of statutory provisions allowing for an "examiner" to investigate, provide information to creditors and the court, mediate negotiations for a workout and monitor the activities of the debtor corporation. In this respect, the duties of the examiner resemble those of a Monitor in CCAA proceedings.

Thus the statutory language of the U.S. Bankruptcy Code appears to afford traditional creditors substantive rights to protect their claims during restructuring. The APR rule, the protection of the liquidation value of their claims under the cram-down provisions, and being the beneficiaries of fiduciary obligation, all serve to ensure that traditional creditors' rights are preserved. However, given all of the ways in which the scheme favours rehabilitation, discussed above, these rights are frequently seriously compromised because of the problem of deferred liquidation. This results in prejudice to creditors' rights from excessive delay and opportunistic behaviour by debtor corporations. It highlights the need for timely and cost effective court-supervised processes that will prevent the unnecessary further depletion of value.

In Mexico, the stay period under suspensión de pagos continues only until creditor approval and execution of the Preventive Plan, and afterwards only on agreement of creditors. On its face, the legislation appears to create a balancing of interests

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1447 Ibid. at 1507.

1448 Miller, supra, note 1405 at 1469. See also M. Bienenstock, “Conflicts Between Management and the Debtor in Possession’s Fiduciary Duties” (1992) 61 Cinn. L. Rev. 543; Frost, supra, note 126 at 119.

1449 Frost, ibid. at 119-20. He suggests that only 15% of all chapter 11 cases have creditors' committees.

1450 Ibid. at 135.

1451 Martinez, supra, note 1300 at 298.
between creditors and the debtor corporation. Preventive Plans under Mexico’s scheme typically propose a period of 2-3 years for paying the creditors. If the debtor corporation is able to secure the agreement of creditors, the Preventive Plan can propose a compromise of debt up to 50% of the amount of claims and/or delayed payment for up to two years.\textsuperscript{1452} The debtor corporation remains in \textit{suspensión de pagos} until the plan is fulfilled and during this period the \textit{Sindico} continues to supervise the activities of the debtor corporation in order to protect the interests of creditors.\textsuperscript{1453} The difficulty is that most workouts are private and thus there is no \textit{Sindico} protecting the collective interests of creditors.

There are a number of foreign lenders who suggest that the system as framed does not protect their claims. They argue that they are frequently excluded from the bargaining process for an effective Preventive Plan because of the preponderance of private workouts and the informal methods and customs that have arisen in Mexico.\textsuperscript{1454} Scholars also suggest that because the \textit{LQSP} is such a debtor-oriented statute and the courts have been inconsistent in its application, both debtors and domestic creditors prefer private workouts.\textsuperscript{1455} Since the \textit{LQSP} process does not actually necessitate a restructuring and usually only includes a delay or compromise of debt, many court-supervised proceedings eventually fail.\textsuperscript{1456} This is because the reason for financial distress is never properly identified and corrected. Moreover, whereas the debt restructuring of the 1980’s involved debt held by only a few large foreign banks, the principal amount of debt of Mexican corporations is now held as Eurobonds by foreign

\textsuperscript{1452} \textit{Ibid.} at 300.

\textsuperscript{1453} \textit{Ibid.}

\textsuperscript{1454} Krawiec, \textit{supra}, note 1295 at 481. Thus an effective court supervised process is not available to protect their interests.


\textsuperscript{1456} Barrett, \textit{ibid.} at 454. Krawiec suggests that from 1975 to 1997 only 30 companies effectively restructured under the suspension of payments procedure, Krawiec, \textit{supra}, note 1295 at 482.
investors.\textsuperscript{1457} Given the maturity dates on these securities and the inability to refinance because of the devalued currency, a number of corporations in the late 1990s are experiencing severe financial distress. Eurobond holders are widely dispersed both geographically and in interest, creating enormous barriers and transaction costs in trying to bargain a workout plan that adequately represents these creditors' interests.\textsuperscript{1458} Krawiec cites conflict of interest and misuse of bargaining power by Mexican banks, corporate directors and owners, resulting in disparate treatment among debt categories.\textsuperscript{1459} Thus, the regime fails to adequately balance the interests of these creditors with domestic interests, often resulting in firm failure.

In addition, the ultimate disposition of a\textit{suspensión de pagos} case is often bankruptcy because of the unwillingness of lenders to advance further capital or shareholders to contribute additional equity, notwithstanding the availability of priority provisions similar to Canadian DIP funding.\textsuperscript{1460} Preventive plans do have some of the same features as Canadian restructuring law in terms of creditor approval requirements. They must be agreed to at a duly convened creditors' meeting presided over by a judge.\textsuperscript{1461} The Preventive Plan must establish in detail the percentage of compromise, the performance guarantees terms of payment and all the requirements that govern the proposal.\textsuperscript{1462} In order for a Plan to be approved, "it must maintain the most absolute equality" in the treatment of common creditors, with concessions or advantages to one or more creditors.

\textsuperscript{1457} Krawiec reports that almost $6 billion (US) of Eurobond debt was due to mature from 1996-1998 at Krawiec, \textit{ibid.} at 483.

\textsuperscript{1458} Including off-shore retail investors, pension funds, insurance companies, and mutual funds, \textit{ibid.} at 484.

\textsuperscript{1459} \textit{Ibid.} at 485.

\textsuperscript{1460} Post-petition financing is allowed to be repaid in normal contractual terms and is not subject to the delays or reductions that other creditors take, and in the event of bankruptcy, this additional capital has priority of payment, but these features are subject to the pre-approval of the bankruptcy Judge and the other creditors. \textit{Statement, supra}, note 1297 at 70, \textit{LSPQ}, articles 26, 58, 414, 417, \textit{supra}, note 1299.

\textsuperscript{1461} In the case of a joint stock company (sociedad anónima) or of a limited liability company (sociedad de responsabilidad limitada), the Preventive Plan must be proposed by the Board of Directors or Managing Partners, with approval of shareholders or limited partners. \textit{Ibid.} at 70.

\textsuperscript{1462} \textit{LSPQ, supra}, note 1299 at articles 297, 300, 301, 303, 304; \textit{Statement ibid.} at 73.
allowed only if expressly agreed to by all of the creditors of the same class.\textsuperscript{1463} The statute specifies that an extension cannot be for a period longer than three years, but practically, the period is often \emph{de facto} exceeded.\textsuperscript{1464} The \textit{LQSP} does allow the debtor corporation and creditors to negotiate conversion of debt to equity or other capitalization arrangements, provided that these are agreed at a duly constituted creditors' meeting.\textsuperscript{1465} However, this rarely happens because of the unwillingness of domestic creditors to extend further credit and because of the view by lenders that the process is just an organized liquidation proceeding.\textsuperscript{1466} Every creditor can participate in discussions to design a Preventive Plan. Secured creditors need not be party to a plan and their rights are not compromised if they abstain.\textsuperscript{1467} If they participate in the meetings and discussions, they lose their status as secured creditors unless they expressly state that they want to participate in discussions while maintaining their security.\textsuperscript{1468} These creditors can also partially waive their privilege and participate and vote in the meeting. If the Plan is not approved, the waiver by the privileged creditors is deemed not to have been made.\textsuperscript{1469} At the approval meeting, at least a majority of creditors have to attend the meeting and at least one-third of them must vote in favour of the proposal.\textsuperscript{1470} The approval process with respect to the value of claims that requires approval is based on a sliding scale.\textsuperscript{1471} Once the Plan is approved, the court holds a sanctioning hearing within 20 days, and will hear creditors or interested parties who wish to be heard, decide any

\begin{thebibliography}{9}
\bibitem{1463} Article 304, \textit{LQSP} ibid.
\bibitem{1464} \textit{Statement}, supra, note 1299 at 73, \textit{LQSP}, ibid. article 318, 322; Krawiec, supra, note 1295.
\bibitem{1465} \textit{Statement}, ibid. at 74.
\bibitem{1466} Alcalde, supra, note 1294.
\bibitem{1467} \textit{Statement}, supra, note 1297, citing article 297.
\bibitem{1468} \textit{Statement}, ibid. at 75, \textit{LQSP}, supra, note 1299, article 309.
\bibitem{1469} \textit{LQSP}, ibid. article 309, 310.
\bibitem{1470} \textit{LQSP}, ibid. article 317.
\bibitem{1471} \textit{Statement}, supra, note 1299 at 75. The lower the payout to creditors, the higher the percentage of value of claims must be to approve a plan. For example, a Plan offering to pay 40% of claims would require approval of 75% of creditors. A Plan, which will pay 75% of claims, requires only a majority of the creditors to approve. The scale is complex.
\end{thebibliography}
outstanding issues, determine that the requirements of the law have been met, assess the sufficiency of the guarantees, and satisfy itself that the debtor could not pay more than what was offered.\textsuperscript{1472}

Thus the statutory language appears to protect the rights of traditional creditors. However, there is considerable debate regarding the ability of traditional creditors to have their claims effectively protected under Mexican restructuring regime. This relates to my discussion in chapter 2 regarding the convergent and divergent interests of stakeholders. In Mexico, it would appear that the traditional institutional lenders have considerable bargaining power in the suspensión de pagos, and where these lenders determine that it is not viable to extend further credit to the debtor corporation, the restructuring or workout is defeated and the corporation is liquidated. The inability of the Mexican judicial system to handle complex restructuring cases results in a large percentage of cases either being prematurely liquidated or being resolved in private workouts.\textsuperscript{1473} Mexican banks dominate these private workouts and Krawiec suggests that these powerful banks are often able to exploit the workout process to negotiate favourable terms for themselves while leaving foreign lenders with little or no recovery on their claims.\textsuperscript{1474} Thus the scheme does not adequately balance the interests of all investors in the firm.

The French model, while it fails to offer an optimal balancing of interests, nevertheless has attempted to balance traditional creditor rights with other interests articulated as priorities under the scheme’s objectives. The French regime has eliminated many of the control rights of creditors, shifting the regime to one that undertakes a more balanced consideration of all stakeholder interests. Prior to the 1986 law, a creditors’ committee, called a “syndic”, was actively involved in approving both operating and restructuring

\textsuperscript{1472} \textit{Ibid.} at 76.

\textsuperscript{1473} Krawiec, \textit{supra}, note 1295 at 481.

\textsuperscript{1474} \textit{Ibid.}
management decisions. The decision to eliminate these control rights arose out of the view that such control was often exercised to defeat the goal of successfully reorganizing the debtor corporation. Under the current law, creditor participation in the reorganization process is far less prominent, although the administrateur judiciaire and the mediator under the reglement amiable process must ensure that the views and interests of creditors are being considered in the workout or design of the plan.

The interests of creditors are also recognized and balanced in other ways. Creditors can initiate redressement proceedings and the onus is on the debtor corporation to establish its solvency or the court will intervene. Moreover, no creditor can be compelled under a plan of redressement to accept less than 100% of its claim, although payments can be stretched over an extended period to a maximum of ten years. Thus there is no equivalent of a "cram-down" of creditors' claims as in the United States or forced acceptance by majority and value of claims in a class as in the Canadian regime.

Creditors can agree to less than 100% payout and a faster payout period, or a combination of the two. Priority of payment is similar to the American priority system. The proposed plan of redressement is circulated to creditors and while it is hoped that a majority are supportive of the plan, there is no creditor vote. Amendments in 1994 to the French legislation provided for the establishment of creditors' committees or advisory groups of up to five creditors. This was in response to concerns that the legislation had moved too far away from traditional creditor rights. The mandate of these

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1475 Koral and Sordino, supra, note 1327 at 441.

1476 Creditors apparently were both seeking to enforce debt collection and shadow managing. Ibid. at 441.

1477 Ibid. at 442; White, supra, note 1327 at 476.

1478 The ten year limit was imposed in the 1994 amendments, and has quickly become the norm. Post petition interest stops accruing. Koral and Sordino, supra, note 1327 at 451.

1479 White, supra, note 1327 at 473.

1480 The plan is circulated to creditors by a lawyer appointed by the court to expressly perform this function. This court appointed officer will also undertake liquidation of the firm should that be the outcome. Ibid. at 451.

1481 Called controleurs, such creditor advisory committees had previously been in the statute but rarely used. Ibid. at 452.
committees is to assist the court in overseeing the administration of the debtor's operation, but they are bound to strict confidentiality and appear most relevant in liquidation proceedings.\footnote{1482 \textit{Ibid.}}

The underlying assumption of the French system is that creditors have their opportunity to negotiate in the informal court-mediated process and that once that fails, creditors have largely lost their opportunity to influence the development of the process.\footnote{1483 \textit{Ibid.} at 453.} Moreover, they can still require payments of 100\% of their claim under the plan. Under \textit{redressement}, the \textit{administrateur} can reject uncompleted contracts, and debts due in the future are not accelerated to the present when the firm reorganizes.\footnote{1484 Unlike in the United States. \textit{White}, \textit{supra}, note 1327 at 478.} Under French law, however, where the court appointed \textit{administrateur judiciaire} sells the business as a going concern, the creditors are no longer entitled to a 100\% return. Rather, the proceeds of the sale provide a fund in which debts are satisfied on a formula basis.\footnote{1485 Koral and Sordino, \textit{supra}, note 1327 at 453.} Thus the French system, while providing some protection to traditional creditors, does not appear to have achieved an optimal balance of interests.

A comparison of these rehabilitation regimes indicates that while all have as an objective the protection of traditional creditor interests, the instruments to accomplish this vary considerably. Where, however, the scheme accords control to the debtor corporation, protection of creditors' interests come in the form of a veto or ability to receive the full amount of claims in advance of approval of the plan or of satisfying the claims of more junior interests.
E. Lessons from Jurisdictions that are Creditor Oriented

The jurisdictions that are debt collection or creditor oriented are by their nature not particularly conducive to the framework that I have suggested in this thesis. This is because debt collection regimes focus almost entirely on the objective of satisfying creditors' claims based on the hierarchy of security set out in the particular scheme. Restructuring is not a substantive objective of the regime.

However, many of these regimes have adopted other policy instruments as a complement to the insolvency regime, that they believe better protects workers' losses because of corporate insolvency. For example, the United Kingdom has a wage earner protection fund. Similarly Germany has a wage earner protection fund administered by its national unemployment insurance fund and receives almost 170,000 claims annually. In addition to these insurance funds, regimes such as Germany recognize workers' human capital investments by having co-determination models of corporate governance both at the supervisory level and in workers' councils. Thus, their policy choices about restructuring must be viewed in the context of the larger policy objectives and the instruments chosen to complement the insolvency regime.

Nevertheless, restructuring policy in these jurisdictions offers some important insights into insolvency law. Even for debt collection schemes, these jurisdictions have recognized the value in creating a workout instrument. For example, in Germany, until recently, there was virtually no mechanism for debtor corporations to restructure their operations. In 1986 there were over 70,000 claims under this fund and workers could receive a maximum of £2,156 ($3,780 Cdn.) for wages and vacation and up to £1,848 ($3,240 Cdn.) in severance pay. Ziegel and Cuming, supra, note 2 at 734.

1486 In 1986 there were over 70,000 claims under this fund and workers could receive a maximum of £2,156 ($3,780 Cdn.) for wages and vacation and up to £1,848 ($3,240 Cdn.) in severance pay. Ziegel and Cuming, supra, note 2 at 734.

1487 Ibid.
affairs. The regime is highly debt collection oriented.\textsuperscript{1488} The predominance of private liquidation meant that in many cases the issue of whether a restructuring would generate greater value for all of those with interests at risk in the corporation was never explored. However, creditors and commercial practitioners found that the failure to have a restructuring mechanism as one component of the system resulted in an excessive number of premature liquidations. Thus, there have been recent statutory changes to enshrine for the first time a mechanism to allow debtor corporations to devise restructuring plan.

One of the difficulties in comparative analysis in this context is that the governance regimes of corporations differ considerably prior to insolvency. Thus, there may be different considerations in the governance of the insolvent corporation. For example, in countries such as Japan or Germany, creditor monitoring, especially by the banks, plays a central role in governance of the solvent corporation.\textsuperscript{1489} This role is reinforced by the fact that the banks also hold considerable equity in the firm, either in the form of direct equity ownership or by use of proxy power over customers’ shares on deposit.\textsuperscript{1490} Moreover, in Germany, the vast majority of debt is secured. Therefore while unsecured claims can be compromised, such an exercise is futile in the absence of a scheme that allows for an arrangement that binds secured creditors.\textsuperscript{1491}

\textit{i. Germany’s New Insolvency Act}

Germany’s recent legislative initiatives are illustrative of my assertion that while policy objectives of comparative regimes are not closely converging, there is a trend to creating

\textsuperscript{1488} In Germany as in the United States and Canada, liquidation often occurs outside of bankruptcy and thus can be a single creditor driven process instead of a court supervised collective process, White, \textit{supra}, note 1327 at 473.

\textsuperscript{1489} Gordon, \textit{supra}, note 9 at 1477; see also T. Hoshi, A. Kashyap and D. Scharfstein, “The Role of Banks in reducing the Cost of Financial Distress in Japan”, in Bhandari and Weiss, \textit{supra}, note 6 at 531.

\textsuperscript{1490} \textit{Ibid.} at 1477.

\textsuperscript{1491} White, \textit{supra}, note 1327 at 473.
alternatives to liquidation in the form of restructuring instruments. This supports my suggestion that it is important to have as an objective a restructuring mechanism that assists in avoiding premature liquidation. Germany adopted a new \textit{Insolvency Act} in 1994, effective January 1999.\textsuperscript{1492} Previously, no formal mechanism existed for the restructuring of insolvent corporations and less than 1\% of insolvent firms tried to reorganize.\textsuperscript{1493} Filing for bankruptcy protection was very expensive and frequently the courts rejected such applications on the basis that the corporation did not have sufficient assets to pay for the proceedings. Thus such proceedings were almost never utilized.\textsuperscript{1494} Moreover, there was no automatic stay, creditors were free to terminate the proceedings at any time, and they had veto power on any compromise of claims.\textsuperscript{1495}

The impetus for the revised legislation was the recognition that firms were being liquidated prematurely and that the average enforcement of claims netted about 5 cents on the dollar.\textsuperscript{1496} The new German law is modeled after many of Thomas Jackson's debt collection theories, while providing for a reorganization procedure.\textsuperscript{1497} It is too soon to assess whether the scheme will be effective, but it warrants several observations.

The policy objective of the new law is to maximize creditor value, and to this end, the law seeks to eliminate collective debt enforcement problems.\textsuperscript{1498} Thus, while the legislation provides for the negotiation of a restructuring plan as an instrument to maximize creditor value, unlike the jurisdictions discussed above, the law is indifferent as


\textsuperscript{1493} White, \textit{supra}, note 1327 at 477.

\textsuperscript{1494} \textit{Ibid.} at 473.

\textsuperscript{1495} \textit{Ibid.} at 477.

\textsuperscript{1496} Kamlah, \textit{supra}, note 1492 at 419. Part of the problems relate to the problem of perfected security, priority of security and the availability of secret liens, issues that are beyond the scope of this paper.

\textsuperscript{1497} \textit{Ibid.} at 421.

\textsuperscript{1498} \textit{Ibid.} at 422.
to whether creditor value will be maximized through reorganization or liquidation. Reorganization is just one possible option for maximizing creditor value. All insolvency proceedings commence as liquidations, and thus the onus is on the debtor corporation or a creditor(s) to persuade the court that the case should be converted to a reorganization case. The law encourages debtor corporations to file for bankruptcy at an early stage, whereas creditors must wait until the debtor corporation is insolvent, a defined term.

Reorganization plans in Germany can propose to modify creditors' statutory rights, the debtors' rights with respect to protection of assets, set rules for the distribution of proceeds from an asset sale, set out the liability of the debtor corporation when the plan is implemented, or provide for the sale of the business as a going concern. The German scheme does not automatically stay creditors' rights to enforce and there are complex rules as to when various classes and priorities of creditors can take action to enforce their claims. Thus, there is often a direct conflict between creditors' rights to enforce claims and the ability to devise a plan of reorganization.

Similarly, creditors have wide ranging rights in terms of appointing an administrator to manage the corporation or to replace the creditors' committee. It is the creditors' meeting that determines whether the corporation will be restructured under the control of existing shareholders and managers or sold on a going-concern basis or liquidated. Thus the focus is not only on creditor value maximization, but also on creditor control of the process. Similarly, creditors vote on any restructuring plan by class and the plan must

1499 Ibid. at 422, 423. Thus while the regime does not consider the continuation of the corporation as a goal per se, it does stay creditors enforcement rights to determine whether reorganization is the optimal means of maximizing creditor value.

1500 Ibid. at 424.

1501 Ibid. at 425.

1502 Ibid. at 427.

1503 For a discussion of this see White, supra, note 1327 at 467.

1504 Ibid. at 429.
be approved by each impaired class of creditors.\textsuperscript{1505} The court has little discretion in terms of sanctioning the plan other than to deal with procedural violations, and the decision of the creditors is paramount in whether to reorganize or liquidate. The exception is where a creditor applies to have a plan set aside and the court can determine that the plan is detrimental to the interests of the creditors as a whole.\textsuperscript{1506} In most cases, an administrator is appointed to operate the insolvent corporation. Even where the debtor with the consent of creditors makes an application to the court to continue to operate the corporation, the court will only make such an order if it does not unduly prejudice the creditors and only with the supervision of an insolvency practitioner.\textsuperscript{1507}

Criticisms of the new law are aimed at the failure to structure creditors' negotiations, and the inability of administrators to swiftly determine whether the corporation should be reorganized or liquidated.\textsuperscript{1508} The inability of the administrators to act effectively means a delay in decisions regarding retention of employees and retention of trade suppliers. Only the debtor corporation or the administrator on request of the creditors can propose a plan of reorganization, an \textit{Insolvenzplan}.\textsuperscript{1509} If creditors have resolved to liquidate the firm, the court will not consider a proposed \textit{Insolvenzplan} by the debtor corporation.\textsuperscript{1510} The system has also been criticized because the ability to deviate from statutory requirements means that there will be increased delay, litigation costs and proceedings on the question of how best to maximize creditor value.\textsuperscript{1511} Interestingly, this same argument is made against including the interests of workers and other stakeholders in

\textsuperscript{1505} Voting takes place by majority in number and by value of the claim. There are numerous provisions specifying how classes are to be determined and specifying that the wishes of the majority of classes prevails if objecting creditors are given an "adequate share" in the payout of claims. \textit{Ibid.} at 431.

\textsuperscript{1506} \textit{Ibid.} at 432.

\textsuperscript{1507} \textit{Ibid.} at 432.

\textsuperscript{1508} \textit{Ibid.} at 423.

\textsuperscript{1509} \textit{Ibid.} at 429.

\textsuperscript{1510} Kamlah, \textit{supra}, note 1492 at 430.

\textsuperscript{1511} \textit{Ibid.}
restructuring proceedings, i.e. that it will lead to increased uncertainty, delay and litigation. Yet as the German model illustrates, and as I noted in chapter 2, there are already diverse and divergent interests at stake even among multiple traditional creditors, and the issue of transaction costs needs to be addressed across all of these types of schemes.

Workers appear not to be a consideration in the development of the Insolvenzplan other than as ordinary creditors. However, under the German scheme, the court and its officers will receive advice from workers' representatives prior to endorsing a plan to liquidate, sell as a going concern or to restructure. Moreover, the German system of codetermination entails workers having at least some access to governance structures through their participation on Aufsichtsrat, which are supervisory boards that oversee performance of the management board. Thus the assumption may be that workers do not require special attention in the governance debate during insolvency, because they are accorded participation rights in the solvent corporation. When the new law was being drafted, the Commission that formulated the legislative proposals included representation by German trade unions. Given that the new restructuring scheme was devised in the context of the complementary policy instruments mentioned above, it may well be that the focus on traditional decision rights in the Insolvenzplan is a complement to national insurance schemes that help workers with adjustment losses, retraining and protection of their human capital investments. A truly effective comparative analysis requires study beyond a comparison of a single policy instrument, i.e., restructuring, although this is beyond the scope of this text.

1512 White, supra, note 1327 at 471.

1513 Kissane, supra, note 24 at 650. In Germany, there is a “wage earner protection fund” that is administered through the Unemployment Insurance regime. It compensates employees for three months of arrears in wages and benefits with no maximum limit on amount of claims. Ziegel et al, supra, note 2 at 734.

1514 Kamlah, supra, note 1492 at 420. I have not been able to ascertain whether the unions ultimately endorsed the scheme.
The United Kingdom is another example of a debt collection regime and many of the same caveats apply with respect to not viewing it in isolation from its other policy instruments that accord value to human capital investments. Prior to 1986 the regime was almost entirely creditor-oriented, resulting in a number of premature liquidations. The 1986 Insolvency Act (IA) was aimed at moving the U.K. slightly towards a rehabilitation system through the creation of an administration where the corporation is insolvent. For example, previously there was no preservation of residual interests by shareholders in receivership, whereas this is now possible under an administration. However, Franks and Torous suggest that the objective of the system remains essentially one of debt collection and at best creates a mechanism whereby dissenting creditors are controlled.

Prior to 1986, the scheme was essentially one of liquidation through receivership. The result of an extensive review into insolvency and bankruptcy resulted in the new legislation, which provided for a restructuring scheme for the first time. A debtor corporation now has access to court protection through stay provisions while the

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1515 Julian Franks and Walter Torous, "Lessons from a Comparison of U.S. and U.K. Insolvency Codes" in Bhandari and Weiss, supra, note 6 at 450, 454. Prior to 1986 it was the receiver who determined whether the firm would be maintained as a going concern or liquidated on an asset basis. Since the receiver faced personal liability for any post appointment liability and given that they often have inadequate information on which to base decision making, the norm was to make the decision to liquidate. The receiver's duty was then confined to selling the firm at the best price.

1516 Franks and Torous, ibid. at 450.

1517 Ibid. at 460.

1518 Ibid. at 464.


1520 Review Committee on Insolvency Law and Practice (the Cork Committee), cited in ibid. at 194.
company tries to work out its affairs. Administration is conceived of as a temporary period during which the parties attempt to formulate a long-term resolution to the debtor corporation's financial distress. The process under the administration provisions is triggered by a petition. This is filed by the company itself, the directors or creditor(s), and specifies that the debtor corporation is unable or likely to become unable to pay its debts. The petition must specify that it would be likely to remedy this financial difficulty by one or more of: the survival of the company as a whole or any part as a going concern; the approval of a voluntary arrangement under the IA; a sanctioning of an arrangement or compromise under the U.K. Companies Act, 1995; or realization of assets under relevant winding up legislation. The statute specifies a long list of persons who may appear at the petition hearing and includes shareholders and creditors and with the court's leave, anyone "who appears to have an interest justifying his appearance". Thus while it is unclear whether any non-traditional creditors or stakeholders have sought access to the process, the legislation explicitly allows the court's discretion to hear from such parties. This is a significant development in U.K. law in terms of the types of participation rights I have argued for.

As with the Canadian scheme, there are a variety of orders that the judge is called upon to determine during the administration process and the court has broad discretion to determine these matters. This includes the ability of either a creditor or a shareholder (called a member) to apply to the court for remedies because the conduct of the Administrator has been unfairly prejudicial to its interests. Thus there are some accountability mechanisms that seek to afford at least some stakeholders access to the process.

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1521 Rajak suggests the law was quite "revolutionary" in this respect because stay mechanisms had only previously been available in liquidation proceedings, supra, note 1519 at 191.

1522 Ibid. at 199.

1523 Ibid. at 200.

1524 Ibid. at 201.

1525 Ibid.
Under the U.K. scheme, the directors and officers of the corporation relinquish power and control on appointment of an administrator.\textsuperscript{1526} Frequently, senior managers remain and these managers or creditor-appointed replacement managers represent the interests of the debtor.\textsuperscript{1527} The decision to place the debtor corporation in administration is a discretionary one by the court.\textsuperscript{1528}

The role of \textit{Administrator} was created for the first time in 1986. The Administrator is appointed by the Companies Court of the Court of Chancery and is an insolvency practitioner.\textsuperscript{1529} The Administrator has broad powers to order disclosure.\textsuperscript{1530} The Administrator is to represent all creditor claims. Since the Administrator is not appointed by a single creditor and is not personally liable for all liabilities incurred after its appointment, she or he has greater flexibility to determine whether an effective restructuring plan can be developed and accepted by creditors. The Administrator has strong powers to stay or delay creditor claims during the plan development stage.\textsuperscript{1531} An Administrator has up to three months to decide whether to restructure, sell as a going concern or liquidate.\textsuperscript{1532} Key to the ability of the Administrator to screen firms in terms of viability is the role played by the creditors' meeting at which the Administrator's proposals must be considered.\textsuperscript{1533} The approval requirements also include the ability of

\textsuperscript{1526} In this respect, the administrator acquires power and control just as liquidators and receivers do under the regime. Franks and Torous, \textit{supra}, note 1515 at 459.

\textsuperscript{1527} \textit{Ibid.} at 459.

\textsuperscript{1528} Rajak, \textit{supra}, note 1519 at 195.

\textsuperscript{1529} Either the debtor corporation or a creditor can make an application to the court for the appointment of an administrator. The appointment of the administrator by the court will be blocked if there is a creditor with a floating charge who appoints an administrative receiver before the appointment of the administrator is made. In such cases, the court has no discretion to appoint an administrator even if it believes that this route would be in the best interests of all the creditors. White, \textit{supra}, note 1327 at 455-56.

\textsuperscript{1530} \textit{Ibid.}

\textsuperscript{1531} \textit{Ibid.} at 455.

\textsuperscript{1532} \textit{Ibid.} at 479.

\textsuperscript{1533} Rajak, \textit{supra}, note 1519 at 201.
creditors to modify the proposal, thus acting as an accountability mechanism to ensure that creditors' interests have been taken into account. Franks and Torous have noted that the appointment of the administrator is most valuable when the interests of creditors are highly divergent, in which case the administrator is most likely to ensure that decision making occurs with a view to maximizing firm value to the benefit of all creditors.\footnote{Franks and Torous, \textit{supra}, note 1515 at 456.}

The administrator can assist with the development of a restructuring plan, called a \textit{scheme of arrangement}. The \textit{scheme} must be sanctioned by the court and requires the support of 75\% of each creditor class vote in order to receive court approval.\footnote{\textit{Ibid.} at 457.} However, the administrator, as with the receiver, must liquidate the firm if the value of liquidation exceeds that of going concern value.\footnote{The difficulty of course is how one values going concern value and whether one takes account of future possible earnings and how. \textit{White, supra}, note 1327 at 470.}

The aim of the new scheme is to reduce the incidence of premature liquidation while at the same time preventing deferred or delayed liquidation.\footnote{Franks and Torous, \textit{supra}, note 1515 at 452.} While no deviation from creditors' claims and priority are allowed in receivership, some compromise is allowed in administrations.\footnote{White, \textit{supra}, note 1327 at 460.} The scheme provides for a stay of secured creditors under the administration procedure, whereas no stay is in effect for a private workout or a receivership.\footnote{\textit{Ibid.} at 474.} Given the primary policy objective of debt collection, however, the slight movement towards a restructuring orientation has been accompanied by a number of accountability measures aimed at minimizing losses to creditors. For example, directors are required to disclose financial distress in earlier stages or they can be disqualified from holding a board directorship for up to fifteen years.\footnote{\textit{Ibid.} at 457.}
While creditors are minimally involved in the process, the period for developing and approval of an administration is relatively short, often only a few weeks or months.\textsuperscript{1541} Scholars have suggested that it is still unclear whether the new system of administration is effective in assisting with restructuring and avoiding premature liquidations. Initial studies indicate that while there is some unevenness in judicial interpretation, the courts have on the whole exercised this discretion to facilitate restructuring and workouts under administration orders.\textsuperscript{1542} While the administration creates the ability for debtor corporations to compromise or shift priorities in order to facilitate successful restructuring, a study of cases in the first seven years did not indicate that the regime had actually moved towards that role.\textsuperscript{1543} This is because there are not yet adequate incentives to encourage creditors to negotiate for a reorganization that would create added value for their interests instead of moving to enforce their claims.\textsuperscript{1544} However, Rajak cautions against conclusions that the scheme is ineffective because of the high number of liquidations. He points out that one of the express objectives of the administration scheme is to also allow for administration orders that provide "a more advantageous realization of the company's assets than would be effected on a winding up".\textsuperscript{1545}

Once the petition for an administration is before the courts asking for an administration order, the court will notify any creditors with a floating claim on the assets of the corporation. Any such creditors with a floating charge over all or substantially all of the corporation's assets can appoint an administrative receiver and thus bring the application

\textsuperscript{1540} From 1986 to 1991 more than a thousand directors were disqualified under these provisions. \textit{Ibid.} at 456.

\textsuperscript{1541} Franks and Torous, \textit{supra}, note 1515 at 460.

\textsuperscript{1542} Rajak, \textit{supra}, note 1519 at 207-210.

\textsuperscript{1543} White, \textit{supra}, note 1327 at 462.

\textsuperscript{1544} \textit{Ibid.} at 462.

\textsuperscript{1545} Rajak, \textit{supra}, note 1519 at 211, citing s. 80(3)(d), \textit{Insolvency Act, supra}, note 93.
for administrator to a premature end. This veto is a powerful tool that results in substantially reduced administration orders. Rajak points out that while the amendments to the U.K. insolvency regime were aimed in part at "employees, the commercial economy and the general public", the reality is that the current regime which allows a single creditor to commence enforcement proceedings results in a situation where these broader interests are not really considered. In this context, the move towards facilitating restructuring continues to be undertaken in a debt collection paradigm. Thus, to date, it does not appear to have embraced any of the notions I have discussed in chapter 2. This may be because of the existence of national insurance schemes for protection of workers. Workers and other stakeholders do not appear to have any participation and decision rights, other than their narrow fixed capital claims.

F. Conclusions

It is evident that much more comparative study needs to be undertaken in order to fully understand how different insolvency regimes have attempted to take account of the diverse interests at risk when corporations are insolvent. The differences in economic and legal regimes in and outside of insolvency clearly influence policy objectives and instruments. Where the regimes indicate some deficiencies in effective restructuring mechanisms, one must remember to situate that scheme in the overall regime for protection and recognition of debt, equity and other interests, and in the complementary policy instruments to protect workers and others. As a preliminary conclusion regarding the restructuring component of such regimes, however, one can observe that while each of the above regimes is moving towards a greater balancing of interests, how they have chosen to accomplish this is not sharply converging.

1546 Rajak, ibid. at 195; White, supra, note 1327 at 476. Over fifty percent of filings in 1987 were blocked by secured creditors in this way.

1547 Ibid. Banks are now altering the terms of their credit to provide for floating charges in order to be able to block access to an administration order should they wish.
The United States regime continues to be plagued by a scheme that fails to effectively balance creditors’ rights with those of the equity holders. This is not necessarily a product of its rehabilitation goals, but rather of the instruments chosen. The proceedings are time consuming, involve costly legal processes required to determine value, and create a relatively unfettered ability of Debtors in Possession to delay decision-making regarding a reorganization plan. While the courts have relied on notions of public interest, workers and other stakeholders are absent from the process to design a plan. Where their rights have been statutorily protected, such as under section 1113 of the U.S. Bankruptcy Code, these rights have proven inadequate to protect their interests because they are plagued with some of the same problems faced by traditional creditors.

Mexico illustrates that even where there is a gap between policy objectives and effective instruments for achieving those objectives, parties will engage in private negotiations for a work out in which they determine what is in their best interests. That workout will include workers where they are considered key in terms of their further human capital investment. However, the scheme appears to have failed to provide adequate oversight of the negotiations and thus bargaining under this regime is unlikely to be optimal.

France’s model has public policy objectives of rehabilitation, however, both the accompanying policy objectives of protection of workers and economic recovery serve to ensure a more textured decision making process in the workout. The scheme’s policy instruments of early and preventive intervention serve to protect and enhance creditors’ investments, including those of non-traditional creditors such as workers. France offers the best comparative model for recognition of workers’ equitable investments in the firm. While other jurisdictions formally recognize the public interest in job preservation, they do not appear to make constructive use of workers’ informational and organizational capital in decision making. The notion of community or other stakeholder participation is almost non-existent other than perhaps the recognition of the decision rights of tort claimants in the United States. Only France has expressly embraced the idea of

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1548 Rajak, supra, note 1519 at 195, and the cases cited therein.
enterprise wealth maximization, although there is some recent caselaw in the U.S. that indicates a slight move in this direction.

Finally, in assessing the debt collection jurisdictions, one can make two observations. First, while both the United Kingdom and Germany continue to maintain their creditor-oriented approach, they have both recognized the need to provide for some opportunity for the debtor corporation to try to work out a viable plan. The underlying policy rationale differs from rehabilitation regimes in that the objective is to further enhance creditors' interests by avoiding premature liquidations. The fixed claims of employees as creditors also benefit to some extent by this development. Moreover, in Germany, the interests of workers are not expressly accounted for in the insolvency process because their participation in governance occurs much earlier in the decision making process in terms of Germany's co-determination model of corporate governance.
The discussion in the previous chapter supports the conclusion that the Canadian insolvency regime has been one of the most effective restructuring schemes for finding an optimal balance between traditional creditors' rights and the interests of other stakeholders. The Canadian scheme allows debtor corporations a period to try to negotiate a viable business and restructuring plan acceptable to creditors, but imposes tight time frames, monitoring and accountability to creditors to ensure that decision-making occurs in a timely fashion.

In Canada, legislative debates and judicial interpretation have suggested that in determining the future of the insolvent corporation, there is an element of "public interest" in the outcome of restructuring proceedings. I have suggested that "public interest" is a "short form" for the complex balancing of interests that the court engages in when determining whether to sanction a plan of arrangement or compromise for the insolvent corporation.

The Court's more express recognition of the "public interest" in corporate workouts is a positive development in the caselaw, one that should be encouraged by all of the involved constituent groups. The investments of non-traditional creditors such as workers, local governments and trade suppliers are interests beyond fixed capital claims. Their
investments are often of a reliance or equitable nature. Moreover, these stakeholders have an interest in the future of the corporation that is not fully recognized in the current scheme. The allocation of decision and participation rights must recognize those who have investments at risk in the corporation, and those who have the incentive to develop a business and restructuring plan that will create efficiencies and added value for the corporation. The presence of workers, unions, local governments and other stakeholders as parties to the court-supervised restructuring process is a vitally important development in this process.

The CCAA affords both the court and the parties the greatest flexibility in recognizing the diverse interests of all those who have made equity, debt and equitable investments in the corporation. Decision-making should be undertaken with a view to enterprise wealth maximization having regard to all interests and investments at stake. This should include all traditional creditors, workers, local governments and others who have not only fixed capital claims but equitable claims on the insolvent firm. My framework suggests that on firm failure, workers and other stakeholders (depending on the circumstances) should have the right as equitable claimants to participate in negotiations and decisions in the development of a viable plan of compromise or arrangement. This role should be given substantive recognition, notwithstanding the fact that the capital claims of workers and others creditors are often very small compared to secured creditors’ claims.

Often with firm failure, there is untapped informational, organizational, and other human capital that can prove key to the development of a sound business plan. This is particularly so when the governance mechanisms of the insolvent corporation are in disarray. Arguably, there is also a broad range of other stakeholders such as local communities, who, in particular situations, have interests at risk in the corporation. While the nature of these claims may be more difficult to quantify, I argue that this should not act as a bar to their participation in the process, if the aim is to develop a restructuring plan that fairly allocates the risks and potential benefits of a financial turn around of the corporation’s economic situation. The court has the discretion to accord
intervenor status even where there are no remaining fixed capital claims. This would ensure that equitable interests are expressed to the court so that it in turn can undertake an effective balancing of interests. However, changes to recognize equitable investments must ensure that these interests are properly balanced against those of secured lenders and other traditional creditors.

I have suggested principles for the reconciliation of traditional creditors' rights with a judicial recognition of the "public interest" that are based on a more textured approach to defining interests at stake in the restructuring of the insolvent corporation. This is not to pre-determine that the optimal outcome of the restructuring process is the rehabilitation, liquidation or some mix of restructuring and sale of all or part of the business assets. However, in advance of such a determination, there ought to be express recognition of the interests at stake and a role for those interests in determining whether there can be an economically viable workout. The Companies' Creditors Arrangement Act is the key legislative vehicle through which reconciliation of such rights can occur, accompanied by a facilitative and supervisory role by the court, including clearer direction to its officers regarding participation and decision rights for all stakeholders with an interest in the insolvent corporation.

The foregoing chapters have highlighted how the case-managed process of the Ontario Superior Court of Justice, Commercial List is a highly effective prototype for judicial oversight of CCAA and other restructuring processes. The availability of specialized expertise and a strong commitment to expeditious and effective case management have resulted in highly successful restructurings and in the evolution of the notion of "public interest" as an important part of the equation.

*Algoma Steel* represents a working model of an expanded notion of fiduciary duty in which directors and officers of the corporation have regard to equity, debt and human capital investments. That restructuring and economic turn around of the corporation
would not have been possible without the protection afforded under the *CCAA*, and without the skilled intervention of the court. *Algoma Steel* represents a major breakthrough in the court’s recognition of workers’ interests and in the acceptance by creditors of the role that workers and their bargaining agents can play in the development of effective plans of arrangement.

The recognition of both a procedural and substantive role for “social stakeholders” in the *Anvil Range* case represents an important step in the evolution of judicial thinking. The court recognized stakeholder interests beyond the very narrow paradigm of traditional creditors and shareholders. The Court expressly recognized the interests of workers, community, First Nations, and other stakeholders, according them not only a procedural role in the *CCAA* process, but considering their substantive interests. Those interests are both social and economic, although they may not be fixed capital claims. The effectiveness of the Court in considering and undertaking the complex balancing of interests among multiple and diverse interests is also evidenced by the *Red Cross CCAA* proceedings. *Med-Chem* illustrates the need for flexibility as well as firmness in case-management.

Internationally, different regimes have attempted to accommodate various stakeholder interests through different approaches and a variety of policy instruments. While the results do not closely converge, they do indicate a public policy trend towards greater balancing of the interests affected in corporate insolvency. Canada’s regime under the *CCAA*, while not without the limitations I have discussed, provides an optimal balance of flexibility and certainty in aiding parties to the restructuring process. It is well situated to provide a more textured approach to the recognition of the public interest, particularly where it involves workers and others with a direct interest in the success or failure of the corporation.

In conclusion, I note that there are some practical lessons for those stakeholder groups that seek to participate for the first time in *CCAA* proceedings. First, it is important to
determine the nature of the claim or interest in the proceedings. The nature of the interest may be simultaneously that traditionally recognized by the court, i.e. fixed claims for wages; may be of the type more recently recognized by the court, i.e. tort claims; or may have the potential for future recognition by the courts, i.e. the equitable investments that workers, local governments, or others have made in the corporation. Often, the nature of the interest will be both fixed and equitable. Determination of this is important because in seeking standing, it is important to identify the nature of the claim to the court and other parties. Where the stakeholders have fixed claims, that may ensure that they are participants. It is then for them to assert their equitable claims in terms of having a voice that is considered by the court in its balancing of diverse interests. In this, the support of insolvency counsel may be key to meshing consideration of non-traditional claims with existing priorities in insolvency.

Second, the stakeholder seeking participation rights must frame any request for access to the proceeding in terms recognized by the court or it must be framed in such a way as to persuade the court to consider granting such rights. For example, in a case where the fixed claims of workers are satisfied early in the process, their equitable claims continue to exist. It may be possible to use the criteria for intervenor status under such court processes as the Ontario Rules of Civil Procedure to argue successfully to the court that it should grant participation rights.

Where public interest or social stakeholder status is being argued, it is helpful to define the nature of the public or equitable interest. For example, in the Algoma Steel case, there was evidence of the impact of corporate failure on the community. While this information might not be readily available and there are costs associated with generating it, it is important that parties engage the court in discussions which have their basis in economics. Evidence of the nature and value of the claim would assist the court in making a determination of the impact of any of its decisions and would provide a clear basis on which negotiations for a workout should take place. Otherwise, public interest becomes too nebulous and too easy to dismiss given the more compelling capital claims of traditional creditors within insolvency legislation.
The Ontario Court's recent directives to traditional parties to make initial stay orders more understandable can help those who are seeking participation rights for the first time. As the Court has observed, often initial stay orders look more like trust documents than initial orders allowing the debtor corporation access to the protective provisions of the statute. This direction by the court for plain language and greater notice can only benefit stakeholders with equitable and fixed capital interests that are seeking participation rights. Moreover, traditional creditors for many years have received financial assistance from the estate of the insolvent corporation in terms of participation in the restructuring discussions, including representation on creditors' committees. More recently, the use of representative counsel has occurred where the debtor corporation believes that it is in its interests to handle diverse or complicated claims in this manner. However, stakeholders themselves who seek participation rights may be able to successfully argue to the court that effective exercise of those rights is contingent on receiving funding for representative counsel. The *CClAA* process has not been adequately recognized for its contribution to Canadian insolvency law and commercial law generally. The current trend of recognizing both the process and substantive roles of multiple stakeholders is a trend that is positive and ought to be encouraged.

As the discussion in chapter 2 illustrated, the interests of workers, tort claimants, local governments and others often converge with those of more traditional creditors. It is important to identify this convergence of interest if there is to be a successful workout for the corporation. Part of this determination requires a more textured understanding of where the costs lie, including the costs of firm failure and the transaction costs associated with enhanced participation rights and greater buy-in of the ultimate restructuring plan. Identifying those may in turn help identify a convergence of interests and a going-forward strategy in the restructuring debate.

The public policy context in which these developments have occurred is one in which the legitimacy of government intervention in the market, including the employment market,
is increasingly being challenged. Governments have responded to these challenges by engaging in a withdrawal from or dramatic lessening of protections for workers in the employment relationship, including their human capital investments. With the choice of public policy instruments shrinking, as governments continue to devolve their protective functions on the market, an increased emphasis on recognizing workers and their interests in the corporate governance and insolvency regimes can provide some (but not all) of the protection of workers' investment formerly provided by remedial legislation.

Corporate and insolvency law cannot provide an effective substitute for remedial employment and labour legislation. However, insolvency law is a policy instrument that is part of a much larger scheme that needs to recognize the investments of workers, creditors and stakeholders, to provide protection against the loss of those investments while at the same time encouraging economic activity. I have noted earlier that government intervention and national wage protection and retraining schemes may be the optimal means of protecting workers' human capital investments. Similarly, legislation or national insurance schemes may have a role in protecting the equitable interests of communities and other equitable investors. However, the existence or absence of such protection does not detract from the exercise that I have engaged in here. My ideas are aimed at providing a complement to, not substitute for, the range of policy instruments available to accomplish these objectives. Insolvency law can co-exist in a more productive and effective way by recognizing more explicitly the equitable investments of the range of stakeholders with interests in the insolvent firm.

Moreover, my proposals regarding insolvency law engage a larger normative framework that may have application across a variety of corporate transactions. Recognition and valuing of workers' equitable investments may, for example, allow for protection in situations such as mergers, acquisitions, hostile takeovers, and restructuring of solvent corporations. The validity of applying this larger normative framework to these

1549 Sarra, supra, note 27 at 21. For example, in 1991, the Ontario government initiated the Wage Protection Program under the Employment Standards Act to provide enhanced protection for workers'
situations is clearly an appropriate area of future study. In the interim, the framework also stands effectively on its own in terms of its application to the restructuring of insolvent corporations.

I commenced this thesis by acknowledging that it would not have been written in quite this way without the benefit of the exchange of ideas with the Canadian insolvency bar, the courts and some of the stakeholder groups that have sought participation rights. A willingness to advance the law, to debate its merits and limitations, and to consider new approaches is a hallmark of the Canadian insolvency regime. I have offered both a systems framework for approaching restructuring decisions, as well as suggestions for how diverse interests can be identified, quantified, and given participation and decision rights in a process which determines the future of the insolvent corporation. The optimal balancing of the diverse interests of stakeholders, including debt, equity capital, human capital and other equitable interests can be accomplished within the current statutory language. This can enhance decision-making and generate surplus value for the firm while still recognizing and largely respecting the current priority scheme for traditional creditors. Just as the history of the CCAA is one of judicial interpretation and evolution of ideas, my expectation is that some of the ideas contained herein will evolve and become part of a more textured understanding of the insolvency landscape.

unpaid wages, and in 1997, the Wage Protection Program was terminated by the government.