INTERNATIONAL INSOLVENCIES AND THE QUEBEC PERSPECTIVE

I. INTRODUCTION

The Canadian *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA) are federal statutes which, in principle, should receive consistent application throughout Canada, regardless of the province before whose courts the particular proceeding may be brought. However, the Province of Quebec is a Civil Law jurisdiction with its Civil Code which does not apply in the other Canadian provinces, and operates under its own body of provincial statutes which may differ from the corresponding statutes in the other provinces.

Quebec's particular legal system and tradition have led some insolvency practitioners to question whether the federal BIA and CCAA have been applied or interpreted differently in Quebec as compared to the Common Law provinces.

International insolvencies are one of the areas examined under this perspective. Do Quebec courts show the same originality and flexibility as courts elsewhere when dealing with complex, international insolvencies or restructurings? Are there differences either in application, approach or fundamental law between Quebec and the other provinces when dealing with international insolvencies and restructurings?

A recent study has reported that since 1977, 50% of Canadian restructurings took place in Ontario 35% in Western Canada and only 12% in Quebec. As a result, there may be a perception in the legal and business communities that practitioners and judges in Quebec are less familiar with all the various possibilities afforded debtor companies in the process of restructuring, especially under the CCAA.

Recent judgments of Quebec courts in insolvency and restructuring show clearly that Quebec is as up to date as the rest of Canada when time comes to render appropriate orders in restructuring situations. In Montreal and Quebec, being the major judicial districts of the province, a commercial division of the Quebec Superior Court has been set up, to hear all proceedings under the BIA and the CCAA (among others).

This experience has proven quite effective, and there is no justification for any reticence in initiating restructuring proceedings in Quebec. Quebec courts, and insolvency practitioners in Quebec, have in fact been involved in numerous important and complex restructurings, some of which have had inter-provincial or international dimensions. For example, Microcell, PCI Chemicals, Concert Industries, to name a few.

The Civil Code of Quebec, and Quebec laws in general, in no way impact negatively on creditor rights, or on the rights of any stakeholders or interested persons, when time comes to issue orders and render judgments in restructurings.

A review of certain examples with international or inter-provincial connotations, will demonstrate this point. Cross-border insolvencies, from a Quebec perspective, are seen as involving issues relating not only to situations between Canada and other countries (especially “Chapter 11” proceedings in the U.S.), but also to situations which often involve Quebec and other provinces.

II. EXAMPLES

The results of our review of recent CCAA cases in Quebec allow us to conclude that there is essentially no difference between orders issued in Quebec and those issued in other provinces.

a) Consolidation

In Uniforêt (500-05-064436-015, April 17, 2001), the Court permitted «substantive consolidation» of the debts and assets of several related companies in order that they be treated, essentially, as one estate for restructuring purposes.

b) Plan of compromise or arrangement

A recent case illustrates that, even if the debtor corporation has no definite plan or even, an outline of a plan, when it files its initial application under the CCAA, it will still benefit from court protection and will be given time (albeit a short delay) to inform the court at the very least, of some of the broad lines of its proposed plan.

In Ailes de la Mode (500-11-022070-037, Dec. 17, 2003), the Honourable Mr. Justice Gascon felt that the initial order, which he was asked to issue, went a bit too far at this early, preliminary stage because the application did not even contain an outline of a proposed plan, or enough details to at least give some indication of what the debtor intended to submit to its creditors. The application described various possibilities or intended scenarios, but this was not enough, in Gascon J.’s opinion, to permit, at this initial stage, the wholesale acceptance of each and every conclusion sought in the initial application.

Gascon J. did, however, issue an initial order that provided for a stay order and a process to finance the restructuring. The court ordered the debtor to return before it within a short delay with more details as to its proposed plan. In the meantime, the debtor was not given, at the stage of the initial plan, power to terminate leases and contracts, and close down stores, but it was afforded protection through the initial stay orders and financing provisions.

This case shows that, in Quebec, courts are sensitive to the need to act quickly in some instances, even if the applicant may not be as ready as it should be with its proposed plan.

c) **Inherent jurisdiction of the Court**

The CCAA is not as detailed as the BIA on certain aspects, nor does it contain specific statutory authority on a number of points which are found, generally, in orders issued under this Act. In many instances courts have held that they have inherent jurisdiction to issue the Order, even if the CCAA is silent. Examples of recent orders based on inherent jurisdiction are:

- power to cancel contracts;
- DIP financing orders;
- Monitor’s and advisor’s charge.

Quebec courts have accepted the principle of inherent jurisdiction just as much as any other Canadian court. See: PCI Chemicals (Mayrand J., August 1, 2001). Consequently, there is no bar, in Quebec, to providing, for example, that the debtor company can cancel or terminate certain contracts as was done in PCI Chemicals.

The case of PCI Chemicals is a good example of the capacity of Quebec courts to deal with complex international restructurings. The Court approved the initial request for approval of a cross-border insolvency protocol in respect to the petitioner relating to proceedings initiated under Chapter 11 of Title 11 of the U.S. Code in the United States Bankruptcy Court, Southern District of Texas. PCI Chemicals was a wholly-owned subsidiary of an American corporation which owned at least one U.S. subsidiary and which was itself wholly-owned by another corporation. The cross-border insolvency protocol was destined to facilitate the coordination of the CCAA proceedings filed by PCI Chemicals before the Superior Court sitting in Montreal with the American proceedings which the parent group filed under Chapter 11.

The cross-border insolvency protocol in PCI Chemicals was approved by Madam Justice Mayrand on August 1, 2001 as part of the initial order issued by her pursuant to the provisions of the CCAA.

The international or cross-border aspects of the PCI Chemicals matter were properly and fully dealt with by Madam Justice Mayrand. Among the issues she considered and ordered, we may note the following:

i) The filing, valuation and treatment of claims and the voting and distribution procedures with respect to certain claims were ordered done in the American Chapter 11 proceedings, even though the creditor may have been Canadian or the claim directed against PCI. In other words, the Quebec court saw no difficulty in treating at least some claims as part of a group of claims to be dealt with by the corporate group restructuring involving PCI as a relatively small, Quebec/Canadian participant;

ii) The meeting of creditors to consider PCI's plan of compromise or arrangement under the CCAA was contingent upon creditors voting and presumably approving the U.S. Plan. PCI and its creditors were, in short, to follow the U.S. lead and nothing would be done in PCI that did not form part of a broader group approach for all companies involved in the restructuring;

iii) After the U.S. Plan had been voted upon, but before the meeting of creditors in PCI, the court permitted the U.S. Balloting Agent to file an affidavit identifying all votes of the Secured and Unsecured Creditors and ordered that all such votes be treated as proxies given to the CCAA Monitor in PCI for the purpose of casting a similar vote in relation to PCI's own Plan;

iv) The statutory Creditor's Committee of unsecured creditors appointed in the U.S. proceedings was given standing before the Quebec Superior Court. The committee did in fact retain local counsel to contest proceedings brought by a company whose contract with PCI was cancelled pursuant to the CCAA Initial Order;

In Vicwest Corp. [2004], 45 C.B.R. (4^{th}) 149, Mr. Justice Ground held that in the absence of any protocol adopted by the U.S. Bankruptcy Court and the Ontario Superior Court of Justice governing the Chapter 11 proceedings and the CCAA proceedings, a Creditors' Committee would have no standing to bring a motion before the Canadian courts to force the production of certain documents related to claims which may be the object of contestations;

In PCI, we have an example, from Quebec, as to how protocols should be drafted and adopted in order, among other things, to give standing to the creditors' committee before our courts;

v) The U.S. proceedings were recognized as foreign proceedings for the purposes of section 18.6 CCAA concerning International Insolvencies;

vi) The cross-border insolvency protocol was approved and, upon the approval by the U.S. Bankruptcy Court, Madam Justice Mayrand ordered that the parties to the Quebec CCAA proceedings and any person shall be governed by the Protocol and shall comply with same.

The Protocol was designed to govern the conduct of all parties in interest in the restructuring proceedings instituted by the corporate group of which PCI was a part, including several American subsidiaries and affiliates. Its main goals were:

– to harmonize, coordinate and minimize or avoid duplication of activities in the U.S. and Canadian proceedings;

– to promote the orderly and efficient administration of the proceedings;

– to establish a consistent procedure for treatment of all claims;

– to honour the independence and integrity of U.S. and Canadian courts;

– to promote international cooperation and respect for comity among the courts, the debtors and all interested parties;

– to facilitate the fair, open and efficient administration of the whole restructuring process;

– to implement a framework of general principles to address basic administrative issues arising out of the cross-border nature of the restructuring proceedings.

d) **D.I.P. financing**

The CCAA does not contain any specific provision which allows the Court to establish this type of financing with a prior ranking charge on otherwise secured assets. The justification is found in the "inherent jurisdiction" of the Court.

The justification for DIP financing, as well as orders granting a first ranking charge for fees of the monitor and other professionals, is clear: absent some form of security for fees and fresh funds, no one would invest in, or work toward, a restructuring.

In Quebec, there has been some discussion as to the validity of this type of financing charge in light of certain provisions of the Civil Code of Quebec and certain constitutional issues. However, there does not seem to be any reticence in recognizing, as has been done in Common Law provinces, the power of courts acting under the CCAA to create a first ranking charge on assets to secure new financing or fees relating to restructuring.

e) **Miscellaneous issues**

Certain recent Initial Orders issued by Quebec Courts under the CCAA have been extremely detailed and complex, covering a number of areas which are also found in Orders issued by courts in Common Law provinces. Conceptually, the broad policy principles behind the CCAA apply, with equal force, in Quebec as in the Common Law provinces. Therefore, it may well only be a question of time before Quebec Courts issue their own precedents on points which have only recently been pleaded or considered by Courts in other provinces and which constitute innovations or recent developments in matters of restructurings.

For example, in Concert Industries, Mr. Justice Journet was called upon to issue an initial order under the CCAA and under the *Canada Business Corporations Act* (CBCA) providing for a joint filing, by several related companies operating in Quebec and in British Columbia, of a consolidated plan of compromise or arrangement.

Section 191 CBCA basically deals with amendments to articles of incorporation of corporations which are the object of orders such as may be issued under the CCAA. Section 192 sets out the rules governing arrangements under the CBCA, which include, as part of restructuring, amendments to articles of incorporation, amalgamations, division of business, transfers of assets and so on.

Concert is, therefore, an example of courts in Quebec working with courts in B.C. in the context of proceedings involving several related companies operating in one province or the other (or both) and seeking not only to reorganize their affairs with their creditors under a plan of compromise or arrangement under the CCAA but, also, to carry out certain internal corporate and business changes using the “reorganisation” and “arrangement” provisions of the CBCA.

Concert is also interesting in that the initial order recognizes the role of a Chief Restructuring Officer (CRO) whose fees are paid, along with those of the Monitor, in priority to any other debt and charge, and constitute a first ranking charge on assets, up to a fixed amount. The initial order also provided for a charge on all assets in the aggregate amount of $1.75 million as directors’ first ranking charge to secure the Directors Indemnity, ranking third among all first ranking charges created under the order (Administrative, Lender’s, Director’s).

III. ISSUES

Despite the great similarity between orders issued under the CCAA in Quebec and elsewhere, are there areas which remain of concern for practitioners dealing with inter-provincial restructurings and the need for consistency and harmonisation throughout the process and in all areas?

a) Labour law issues

It is important to note that Quebec has an extremely well developed body of statute and case law on labour matters.

Article 45 of the Quebec Labour Code was amended in 2001 to remove the exception «judicial sale» from the general principle that the sale or alienation of a business did not annul the accreditation of the union nor the collective agreement in place: both followed the sale and the new buyer was "stuck" with them. A number of cases had held that a sale by a trustee under the BIA was included in the notion of judicial sale. Therefore, prior to the amendment to article 45 Q.L.C., a trustee could sell, in principle, free and clear of any union or collective bargaining agreement. Many bankruptcies can be explained in part by a desire to "get rid" of unions in this way.

The amendment to article 45 seeks to remedy this perceived injustice towards unions and employees. Whether the amendment in fact achieves this purpose may be open to some dispute.

Nonetheless, for our purposes, it is not necessary to examine this issue in detail. Suffice it to say that there may be differences between Quebec Labour Law and labour laws found in other provinces. In restructurings involving employees, unions or collective agreements governed by Quebec Law, great care must be taken to ensure that there is no strategic or legal error committed because of a misapprehension as to what can or cannot be done in a labour context.

The best example of this is Mine Jeffrey where Mr. Justice Fournier suspended the collective agreements in his initial CCAA order and allowed the monitor to bypass the unions and hire employees directly, without complying with seniority and stipulated salary scales and without being bound by any provisions in the collective agreements.

Leave to appeal was granted by Madam Justice Louise Otis of the Quebec Court of Appeal who ordered that the appeal be heard on an urgent basis.

The Court of Appeal, in Mine Jeffrey, rendered its decision on January 31, 2003 and reversed Mr. Justice Fournier. The Court recognized that the

CCAA could not be used to set aside or render inoperative, a collective bargaining agreement or the status of unions to represent employees.

The reasoning of Mr. Justice Dalphond, speaking for the Court, can be summarized as follows: a monitor under the CCAA is a person named by the Court to oversee the restructuring. No assets devolve to him (as would be the case with trustees in bankruptcy). Therefore, the debtor company remains the employer, and the monitor, in dealing with employees, is agent of the debtor. The monitor is not the new employer. Mr. Justice Dalphond went on to hold that it is doubtful that the court acting under the CCAA could abolish or modify union accreditations, especially given the absence of any statutory provision to such effect in the CCAA.

Therefore, unions remain as sole representatives of the employees vis-à-vis the employer, even if the latter is now represented by a monitor. If the accreditations are valid, their effects remain. Hence, the monitor cannot, as regards positions included in the bargaining units, ignore the unions in dealing with the employees, and cannot conclude valid employment contracts directly with employees.

The Court recognizes that the monitor, acting on behalf of the employer, can lay off or fire employees. However, that is not the same as ignoring unions or setting aside collective bargaining agreements.

As for the conditions applicable to employees who are retained or called back, the court held that the CCAA does not allow the court to order a person to furnish services without getting paid, nor does it allow the imposition of a consideration for such services in a unilateral, non-consensual fashion. For instance, wrote Mr. Justice Dalphond, a court under the CCAA could not force a landlord to accept less than what is stipulated as rent in a lease. The same applies to unionized employees: the employment contract must be respected. Nothing, however, prevents the union and the monitor from negotiating a suitable compromise agreement (as in fact was done in Mine Jeffrey).

Finally, the Court held that the power given to a monitor to terminate contracts does not extend to collective bargaining agreements or to union accreditations.

On the issue of whether or not Mine Jeffrey could, under the CCAA, suspend its contributions to the employee pension fund, suspend its payment of arrears to this fund and suspend the payment of insurance premiums for retired employees, the court, noting the evidence adduced in first instance that the total of these payments would be impossible to meet and would inevitably lead to bankruptcy, confirmed that suspension could be ordered. In this regard, the Court followed the Ontario Court of Appeal case of Royal Oak Mines Inc. [2001] O.J. 562 (Ont. C.A.).

It is important to note that section 1113 of Chapter 11 of the U.S. Bankruptcy Code does allow the Court to modify collective bargaining agreement in the U.S. Collective agreements are “contracts” within the meaning of that Code and the Trustee can, with leave of the court, continue or terminate any contract. However, the particular nature of collective bargaining agreements obliged the “debtor in possession” or the “trustee” to attempt to negotiate in good faith with the union, before seeking leave of the Court to set aside the collective bargaining agreement. The Court also had to be satisfied that this measure was appropriate for restructuring (see Mine Jeffrey note 25).

b) **Vitality and adaptability of Quebec law**

In numerous recent cases in Quebec, the Court has reaffirmed the primacy of the broad policy considerations behind restructurings under the CCAA and also, under the BIA. We are aware of no contested case from Quebec Courts in which the Court would have refused, as a matter of law (as opposed to a decision based on the particular facts or circumstances of the case) to order, in a CCAA restructuring, the same type of conclusions as are found in similar cases coming from Common Law provinces.

Once the principle of inherent jurisdiction is confirmed (Mayrand J. in PCI Chemicals, leave to appeal refused by Mailhot j.c.a.) and once the objectives behind corporate restructurings are brought to the forefront as the main principles guiding the courts in their determination as to what should or should not form part of an initial or subsequent CCAA order, there is really no particular rule of law in Quebec that would prevent insolvency practitioners from being as creative as anyone else.

Whether we are dealing with the notion of “critical suppliers”, the appointment of Chief Restructuring Officers to help in the restructuring (see Concert Industries, supra), increased powers to Interim Receivers appointed under the BIA and recognition of Creditors Committees in international insolvencies, among others, Quebec Courts have been as responsive as Courts elsewhere in issuing orders that meet the needs of the particular situation.

In Quebec, using the various recourses and options available under the BIA, the CCAA or the Civil Code of Quebec (especially dealing with realization of hypothecary rights), practitioners have been able to structure modern, workable solutions to complex problems. Whether the context is one of insolvency, restructuring or realization of guarantees by a secured creditor, Quebec Law is perfectly suited to meeting the needs of all interested parties.

For example, in Arell Machinering Ltd. and Airborne Gear and Mach Ltd. (500-11-019829-031 and 500-11-019830-039), a Montreal based debtor was in default to its secured creditors.

This Montreal company was a wholly owned subsidiary of an American company which was in the process of a Chapter 11 restructuring. The U.S. Plan provided for the sale of the subsidiary's assets located in Quebec following a particular process set out in the U.S. Plan, known as the "Stalking Horse" process. The idea here is to have a person make an initial offer, which is then used to obtain better bids. The initial offeror is compensated in the event his offer is not retained. The purpose is to try to obtain the best possible realization. The Canadian bankers were supportive of this idea, for obvious economic reasons.

The challenge was to carry out the objectives set out in the U.S. Plan using the tools available in the CCAA, the BIA or the Civil Code. The solution which best achieved the desired result used a combination of certain provisions of the BIA and the Civil Code: an interim receiver under s. 47 BIA was named with power to follow the bid process in the U.S. and eventually to cause the debtor to effect a transfer of its assets to the winning bidder. In parallel, the secured creditors were in a position to continue their proceedings to realize upon the assets subject to their security and the interim receiver was designated by the Court as the person who would carry out the judicial sale.

The tie-in was that the judicial sale would be to the first bidder, or to any other bidder who, through the Stalking Horse process, would eventually wind up with the winning bid in the context of the U.S. Plan.

The Quebec Courts approved the foregoing proceedings and thereby gave effect to the "Stalking Horse" process. The secured creditors, through the appointment of the interim receiver, ensured that receipts and disbursements would be controlled and that there would be a follow-up on the bid process in the U.S. The proceedings for judicial sale of the secured assets, with the interim receiver being designated to carry out the sale, provided the practical mechanism to carry out the sale once a winning bidder was found through the use of the "Stalking Horse". This judicial sale also gave the buyer free and clear title, as provided for by Quebec law, thereby avoiding the possible difficulties resulting from a "Vesting order" under the CCAA or BIA.

In Boutiques San Francisco (Ailes de la Mode) (J.E. 2004-714), Mr. Justice Gascon had to deal with the following situation. An offer had been accepted for one of the debtor's better located stores for $415,000. Another bidder, whose initial bid had been refused, decided to offer $100,000 more on its initial bid, even though the first one had been accepted and the acceptance had been ratified by the debtor's board of directors. Seeing this, the first bidder upped its offer to $540,000, which was in excess of the increased bid of the second party but petitioned the court for a determination that its first offer should stand. In response, this second party upped its offer yet again, by another 100,000, and asked the Court to hold that the interests of creditors to maximize realization ought to override mere technical considerations involving the bid process.

Mr. Justice Gascon held that the integrity of the bid process put in place to treat all bidders fairly should take precedence over mere monetary considerations of $200,000 more for the mass. He ordered that the sale be effected in accordance with the first accepted offer. He further ordered that the sale be done free and clear of all charges, and that provisional execution notwithstanding any appeal be applied.

IV. CONCLUSION

The foregoing survey of recent CCAA and other cases in Quebec shows that we in Quebec share the same concerns and seek the same solutions as practitioners in other provinces dealing with restructurings and insolvencies. Quebec Law affords all the necessary elements for practical and efficient solutions to a number of complex issues and problems. The vitality of Quebec law is one of its strengths and professionals involved in restructurings have no reason to avoid Quebec when time comes to proceed with complex restructurings.

Section 9 of the CCAA sets out the jurisdictional criteria for filing an application: where the debtor company has its head office or “chief place of business” or if the company had no place of business in Canada, in any province in which any of its assets are situated. The choice between these places for filing should not matter: the CCAA (and BIA and CBCA) are federal statutes and should be of consistent application throughout Canada.

There may be a perceived difference in the application and interpretation of these jurisdictional criteria from one province to the next, but in reality, the quality, details and substance of orders issued by Quebec courts are on a par with anything else coming out of Common Law provinces. With the Commercial Division of the Quebec Superior Court and the work of the committee set up by the Quebec Bar to make recommendations to improve the handling of important restructurings and insolvencies, there is no basis in fact to consider Quebec a jurisdiction which is, in any way, detrimental to any creditor or debtor rights in these areas.

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May 2004