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## About the International Insolvency Institute

The International Insolvency Institute is a Canadian non-profit association of leading insolvency practitioners, academics, judges and regulators from over 35 countries world-wide. Its objectives are the improvement of international insolvency systems and procedures and it is dedicated to advancing and promoting insolvency as a respected discipline in the international field.

Further information on the Institute and on the Institute's developing collection of electronic insolvency resources appears on the Institute's website (which is under development) at *www.iiiglobal.org.* The Institute appreciates the opportunity to be able to make submissions to this Committee.

## Author's Qualifications And Background

Mr. Leonard is the Chair and a Director of the International Insolvency Institute and is the partner-in-charge of the Business Reorganization Group at Cassels Brock & Blackwell LLP in Toronto, was admitted to practice in 1970 and has practiced insolvency for almost all of his entire career.

Mr. Leonard is Past Chair of the International Bar Association's Committee on Insolvency and Creditors' Rights (comprising 1200 lawyers from over 80 countries). He is a Founding Member of and served as the Chair and a Director of The Insolvency Institute of Canada, a limited membership invitational organization of senior insolvency professionals in Canada, from its inception in 1990 to 2002. Mr. Leonard is the Chair, a Director and a Founding Member of the International Insolvency Institute, a limited membership global organization of senior insolvency professionals.

Mr. Leonard is a Member of the American Law Institute where he served as Chair and Co-Reporter for Canada on the American Law Institute's *Transnational Insolvency Project*. He served as the Co-Chair of the Government of Canada's Bankruptcy and Insolvency Committee Working Group on International Insolvencies and is a Member of the Ontario Court of Justice Chief Justice's Committee on Commercial Law Proceedings. Mr. Leonard is a Past Director of the American Bankruptcy Institute and Co-Chair of the ABI's International Committee (1997-2000). He was elected as the only international Conferee of the United States National Bankruptcy Conference and is a Fellow of the American College of Bankruptcy and a Fellow of the American Bar Foundation. Mr. Leonard served as Co-Director of the LL.M. Program in Insolvency Law

at the Osgoode Hall Law School of York University, Canada's only graduate program in insolvency.

Mr. Leonard was selected for the *Guide to the World's Leading Insolvency and Restructuring Lawyers* (First, Second and Third Editions, 1997, 1999 and 2002) and has been named to *Canada's Top 500 Lawyers* (*Lexpert/American Lawyer*) in its first five years of publication from 1999 to 2003. He is also Past Chair of the Insolvency Law Section of the Ontario Bar Association and served as Vice-Chair of the International Bankruptcy Subcommittee of the American Bar Association's Business Bankruptcy Committee.

Mr. Leonard is the Co-Editor of *Current Developments in International Insolvencies and Reorganizations* (Graham and Trotman: London, 1994), Co-Editor of *Multinational Commercial Insolvency* (American Bar Association: Chicago, 1993), and the author of *Guide to Commercial Insolvency in Canada* (Butterworths, 1988). Mr. Leonard is a Contributing Editor of *Norton Bankruptcy Law and Practice,* a Contributing Editor of *Collier's International Business Insolvency Guide*, a Contributing Editor to the American Bankruptcy Institute *Journal* and a member of the Editorial Board of *Tolley's Insolvency Law and Practice* (London). Mr. Leonard has participated in many of the most significant reorganizational proceedings in Canada and internationally including Olympia & York, Confederation Life Insurance, Johns Manville, Cadillac-Fairview, Dome Petroleum, Massey-Ferguson, Bramalea Inc., Everfresh Beverages, Dow Corning, Eaton's of Canada, Philip Services, Loewen Group, Standard Trustco, Canadian Airlines, 360 Networks, Owens Corning, AT&T Canada, GT Group Telecom, Teleglobe Inc., and Air Canada, among others.

## THE GLOBALIZATION OF BUSINESS AND THE GLOBALIZATION OF REORGANIZATIONS AND RESTRUCTURINGS

The tremendous advances in information technology within the last fifteen years have made it possible for businesses to operate in a variety of different countries at the same time and to link all of these operations as if they were right next door. A multinational business operating profitably and internationally can make decisions quickly that affect its global operations; it can allocate resources internationally in a manner which best suits its objectives and it can utilize its going-concern values to augment the value of its underlying operating assets on the basis that the whole is greater than the sum of the parts.

The onset of an insolvency case, however, stops all that and turns the business into a series of disconnected segments in several different countries. In a typical international insolvency, different sets of creditors assert different kinds of claims to different assets under different rules in different countries. The international business that was once carried on comes to an end and separate, unconnected remnants of the organization attempt to continue until they either starve or implode. It is almost as if a cross-border insolvency system had been set up deliberately to *promote* failures and liquidations.

The structural framework for dealing with multinational and cross-border businesses that encounter financial difficulties has hardly evolved from the state it was in several decades ago. There have been initial and limited domestic legislative initiatives into the area of co-operation in international insolvencies and restructurings but until the UNCITRAL Model Law (discussed, *infra*) is widely enacted, however, the legal structure internationally for enterprises in financial difficulty can best be described as compartmentalized. When insolvency or financial failure affects a multinational business, it is still most commonly dealt with through a variety of independent, separate and often-unconnected administrations, most often for different, if not conflicting, purposes.

Consider the contrast in domestic terms as if traditional international insolvency rules applied to a domestic business in financial difficulty. Suppose that the financially-troubled business had operations in Toronto, Montreal and Vancouver instead of in England, France and the United States. After a filing, the portions of the business in Toronto, Montreal and Vancouver would be run separately by different court-appointed officials. None of the courts involved would be obliged to recognize orders made by another court and there would be severe

pressure from local creditors for local courts to ignore the proceedings in the other courts entirely. Legislation would typically prefer local creditors over others. Transactions between the different portions of the business would grind to a halt. Receivables would be collected in the jurisdiction of the account debtor and would not be released to any of the other courts or creditors. Internationally, this has been the traditional result in cross-border cases and it is only relatively recently that the insolvency profession and the courts have been able to work toward a system that pays more attention to the interests of the stakeholders than to issues of the national sovereignty of the jurisdictions involved.

The dual impact of globalization and technological innovation has changed international commerce forever. Transactions involving multinational businesses can be carried out in mere seconds, regardless of the geographical location of the parties to the transaction. Transactions among units of the same global enterprise have also moved firmly into the 21st century but, where unforeseen or unfortunate circumstances lead to the need for reorganizations or restructurings, the pace of coordination and communication among jurisdictions reverts to the 19th century. By and large, the stakeholders of global businesses are the losers in this technological regression.

Globalization has presented very significant challenges to international reorganizations and restructurings. By the same token, globalization has contributed a deep awareness of the need for improvements in systems that assist and enhance the prospects for a successful cross-border and multinational reorganizations which preserve and maintain stakeholder values. The purpose of these submissions is to address some of the major trends in the international insolvency area that can lead toward improvement in Canadian international insolvency systems and procedures which will benefit all the stakeholders involved in multinational and cross-border businesses.

## PRESERVATION OF VALUE THROUGH COORDINATING CROSS-BORDER ADMINISTRATIONS

The most logical and obvious solution to improving the current state of international co-operation in insolvencies and reorganizations would be a multinational treaty or convention to deal with insolvencies and reorganizations of multinational businesses. In practice, however, multinational treaties and conventions have proved exceptionally difficult to arrive at. There are very few functioning examples of international treaties on insolvency and reorganizations. The European efforts that took over 30 years to reach fruition perhaps illustrate the difficulty in negotiating an effective international insolvency convention. Clearly, multinational conventions cannot be expected to be the primary means of achieving significant improvement in the international insolvency area.

Bilateral treaties between countries are another option. These are easier to negotiate but there are still very few examples of functioning bilateral treaties in existence. The difficulty with bilateral treaties as well as with multinational treaties is that they become exercises in the negotiation of sovereign rights. What is needed more is an appreciation that treaties or conventions on international insolvency and reorganizations really primarily represent the regulation of commercial interests in the event of a financial failure. As long as the negotiation of treaties remains in the realm of sovereignty and national interest, the road toward a successful conclusion of a treaty or convention will be hard to find and successful efforts will be few and far between.

In the absence of effective treaty or convention arrangements, the choice in a multinational or cross-border insolvency or reorganization seems to be primarily between a primary/secondary jurisdiction structure for an administration on the one hand and a concurrent/parallel proceedings structure on the other. In concept, a primary/secondary jurisdiction model would involve a filing in the primary jurisdiction where the debtor's central operations are located and subsequent secondary filings in jurisdictions where other assets are located. In the concurrent/parallel jurisdiction model, the reorganizing business would file full proceedings in both the jurisdiction where its central operations are located and in other jurisdictions where key assets are located.

In a genuine primary/secondary model, the secondary jurisdiction would defer in major respects to the primary jurisdiction even, perhaps, to the point of turning over assets for administration in the primary jurisdiction. Conceptual difficulties will arise, of course, where the first case to be filed is in the “secondary” jurisdiction rather than the jurisdiction of the debtor's central operations. Moreover, recent experience has shown that some businesses opt to locate their offices in jurisdictions that are inconvenient for the creditors, thereby giving rise to an initial threshold

issue in the proceedings as to which jurisdiction is the primary jurisdiction and which jurisdiction is the secondary jurisdiction. In addition, experience has shown that courts in all countries continue to be influenced by the interests of domestic creditors and that the courts of one jurisdiction are generally reluctant to yield authority or concede primacy to the courts of another. Consequently, administrations that appear to fall within the primary/secondary model may in fact actually be examples of the concurrent/parallel proceedings model.

It is clear, however, that courts in different countries are capable of cooperating with each other and coordinating their administrations in the case of a cross-border or multinational reorganization or insolvency. The key to this increased willingness to cooperate and coordinate may well lie in the experience gained from Cross-Border Insolvency Protocols that have been negotiated in recent cases and from the example of the International Bar Association's Cross-Border Insolvency Concordat (which is discussed below).

Recent international experience with concurrent proceedings shows that orderly administrations of portions of business entities in different countries can be successfully carried out. The Concurrent Proceedings model recognizes the reality of a situation in which the courts of one jurisdiction are reluctant to yield their jurisdiction to the courts of another but wish to coordinate their administrations. By working concurrently but also in concert, administrations in more than one country can be carried out in a harmonized fashion which will be to the benefit of all of the stakeholders involved in the process.

In the North American context, the integration of the Canadian and United States economies following NAFTA has meant a much higher degree of integration of businesses in Canada and the United States. There is a justifiable concern based on practical experience that a trend seems to be developing in which major Canadian companies are pulled or pushed into reorganizations in the United States. The consequences are that, among other things, Canadian creditors with Canadian financial relationships are required to go to the United States to participate in the reorganization of Canadian companies. Moreover, Canadian companies that do reorganize successfully in the United States will inevitably remain in that country, contributing to the so-called "hollowing out" of Canadian commerce. These submissions will therefore also offer some contrasts between Canadian insolvency systems and procedures and those that exist in the United States and will comment on some major areas in which significant improvements should be made in the Bankruptcy and Insolvency Act (the "BIA") and the Companies' Creditors Arrangement Act (the "CCAA") to safeguard and enhance the interests of stakeholders who become involved in the insolvency process in Canada.

## CANADA'S INTERNATIONAL INSOLVENCY STRUCTURE

The BIA and the CCAA were amended in 1997 to include for the first time in Canadian legislation major provisions dealing with cross-border insolvencies and reorganizations. The Concurrent Proceeding model was adopted by Parliament as a means to facilitate cross-border reorganizations and restructurings. It was intended to ensure that the interests of domestic Canadian creditors would not be unduly prejudiced or neglected in cross-border cases. The Concurrent Proceedings model was intended to ensure that assets in Canadian cases were not transferred out of Canada and beyond the reach of Canadian courts and that the claims of Canadian creditors would not be unfairly prejudiced or diluted by unfair or artificially-enhanced claims from other jurisdictions. It was not the intention that Canadian creditors would receive better treatment than creditors in other countries but that Canadian creditors, to the extent that Parliament could assure this result, would be treated equally with creditors in other jurisdictions through the coordination of proceedings in Canada with proceedings in other countries.

The 1997 amendments were derived from recommendations made by the Federal Government's Bankruptcy and Insolvency Advisory Committee ("BIAC"). The BIAC process involved eight major Working Groups, one of which was constituted as the Working Group on International Insolvencies which the author was privileged to Co-Chair with the Superintendent of Bankruptcy. The Working Group on International Insolvencies deliberated over eighteen months on the complex issues involved in international insolvencies and reorganizations.

The new international provisions of the BIA allow Canadian courts to grant relief to facilitate or implement arrangements that will result in a co-ordination of proceedings in Canada with proceedings abroad and allow assistance to foreign insolvency representatives. Under the new provisions, foreign representatives are allowed to take insolvency proceedings in Canada in the same fashion as Canadian creditors. Specifically, a foreign representative can commence bankruptcy proceedings and proposal proceedings as if it were a creditor, trustee or receiver of property of the debtor or as if it were the debtor itself. On an application to the Canadian court by a foreign insolvency representative, the court can grant a stay of proceedings against the debtor or its property on terms consistent with the relief provided for in the normal stay provisions under the BIA. The court can also appoint an interim receiver of the debtor's property in Canada and direct the receiver to take conservatory measures or to take possession of the debtor's property and

exercise such control over the property and over the debtor's business as the court considers appropriate. The interim receivership powers that can be granted to a foreign representative are similar to those in the BIA.

A foreign representative may bring an application for assistance to the Canadian courts notwithstanding that there may be proceedings by way of review or appeal against its authority in its home jurisdiction. Its application does not constitute an attornment to the jurisdiction of the court except as regards the authority of the court to award costs of the proceedings. The court can also authorize the foreign insolvency representative to conduct examinations of Canadian residents to assist in its administration.

One of the critical components in cross-border coordination and harmonization is the ability for the courts and the professionals involved in each jurisdiction to communicate with each other. The 1997 legislation contained provisions which were unique and precedent-setting. Canadian courts in multinational cases were allowed to seek the aid and assistance of a court, tribunal or other authority in a foreign proceeding by way of order, written request or “otherwise as the court considers appropriate”. This provision was a recognition derived from the BIAC process that modern means of communication are developing and evolving at a remarkable pace and that the manner in which communications should be carried out effectively, fairly and efficiently should be determined by the courts themselves.

The new provisions also contain a number of ancillary measures to deal with issues that had previously been dealt with by Canadian courts on a case-by-case basis. Provision was made to ensure that creditors who participate in both a Canadian administration and a foreign administration account for their recoveries so that their recovery is no greater than that of a creditor who has participated only in the Canadian administration. Claims that are payable in foreign currency are converted into Canadian currency as of the date of the bankruptcy of a debtor or as of the date of the filing of a Notice of Intention if a proposal is involved, unless the proposal itself provides for a different treatment. From an evidentiary point of view, the amendments allow a bankruptcy, insolvency or reorganizational order made in a foreign proceeding to be proved by simply filing a certified or exemplified copy and allow the Canadian court to treat the order as *prima facie* proof of the insolvency of the debtor and of the appointment of the foreign insolvency representative.

While there was originally a discussion as to the extent to which Canadian courts should be permitted to turn over assets in Canada to be administered in other jurisdictions, this power was specifically not included in the amendments. As transfers of assets from one jurisdiction to another have historically been rare in practice and since Canada's insolvency processes have always been largely creditor-controlled, the new provisions deliberately abstained from attempting to resolve these issues in favour of allowing them to be dealt with by a parallel distribution of assets in a concurrent Canadian proceeding.

Amendments were also made to the CCAA to deal with cross-border and multinational reorganizations. These amendments were comparable to the amendments to the BIA but were not as extensive. The new amendments include the power of the court to grant relief to facilitate the co-ordination of arrangements under the CCAA with foreign proceedings. The same protection against attornment for foreign insolvency representatives was provided under the CCAA and the court was given the same ability to seek the aid and assistance of a foreign court or other authority in a foreign proceeding. The amendments to the CCAA did not contain the BIA's provisions on the ability of the court to appoint an interim receiver on the application of a creditor in CCAA proceedings. The ability of a foreign representative to bring an application regardless of appeal or review proceedings in its home jurisdiction was not intended in the CCAA amendments nor was the rule requiring creditors to receive the same proportionate dividends regardless of the administrations they participate in.

# THE MODEL LAW ON CROSS-BORDER INSOLVENCY DEVELOPED BY THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE (UNCITRAL)

## Origins and Development

The United Nations Commission on International Trade Law (UNCITRAL) is a major United Nations organization headquartered in Vienna which has undertaken exhaustive studies and reviews in a wide variety of significant areas of international commercial law. Its efforts have led to many international conventions and model laws which have been widely adopted in Canada and around the world and, most recently, produced the UNCITRAL Model Law on Cross-Border Insolvency (the “Model Law”).

UNCITRAL began a study of the feasibility of achieving higher levels of co-operation in the international insolvency area in April 1994. The objective in developing the Model Law was to establish a set of uniform principles that would deal with the requirements which a foreign insolvency representative would need to meet in order to have access to the courts of other countries in cross-border cases. The Model Law Project, however, evolved into a much broader work and ultimately became an agreed-upon international model for domestic legislation dealing with cross-border insolvencies that could be adopted anywhere in the world with or without variations that would reflect local domestic practices and procedures. The Official Text of the Model Law has now been published and widely disseminated and is available on UNCITRAL's web site (at *http://www.uncitral.org*). The text of the Model Law is included with the CD-ROM that accompanies these submissions, and is also available on the International Insolvency Institute website at *http://www.iiiglobal.org/organizations/uncitral/model_law.pdf*.

## The UNCITRAL Model Law System

The primary goal of the Model Law is to facilitate domestic recognition of foreign insolvency proceedings and to increase international co-operation in multinational cases. Foreign insolvency proceedings are divided into two categories in the Model Law, i.e., “main” proceedings and “non-main” proceedings. A main proceeding is one which takes place in the country where the debtor has its main operations. If the foreign proceeding is recognized as a *main* proceeding, the Model Law provides for an automatic stay of proceedings by creditors against the debtor's assets and the suspension of the right to transfer, encumber or otherwise dispose of the debtor's assets. The scope and terms of the stay of proceedings are subject to the normal requirements of domestic law.

If the foreign insolvency proceeding is recognized as a *non-main* proceeding, a variety of relief is available which is not automatic and is in the discretion of the domestic court. If it is necessary to protect the assets of the debtor or the interests of the creditors, the domestic court may grant a stay of proceedings against the debtor and its assets, suspend the right to transfer or deal with the debtor's property, entrust the administration of the debtor's assets to someone designated by the court and authorize depositions and taking of evidence. This relief may be made subject to whatever conditions the domestic court considers appropriate and the domestic court may modify or terminate the relief either at the request of the foreign insolvency representative, or a person affected by the relief or on its own motion.

The Model Law contemplates a high level of co-operation between courts in cross-border cases. Domestic courts are directed to co-operate "to the maximum extent possible" with foreign courts and foreign insolvency representatives in the Model Law: Article 26. The courts may communicate directly with each other and may request information or assistance directly from the foreign court or from the foreign insolvency representative: Article 25. Co-operation can, for example, consist of appointing someone to act on the direction of the court, communicating information by any means considered appropriate by the court and co-ordinating the administration of the debtor's assets and affairs in both jurisdictions: Article 27. The courts may also approve or implement agreements concerning the co-ordination of concurrent proceedings involving the same debtor: Article 30.

In considering the Model Law, it is important to note that the Model Law preserves the rights of domestic creditors to commence domestic insolvency proceedings: Article 20(4). The Model Law also stipulates that in granting recognition to foreign insolvency representatives in both foreign main proceedings and foreign non-main proceedings, "the Court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected": Article 22(1). The domestic Court may add appropriate conditions to any recognition of a foreign main proceeding or a foreign non-main proceeding and may, on the request of a domestic creditor or on its own motion, terminate relief granted to the foreign insolvency representative: Article 22(2) and (3).

These provisions were inserted to ensure that the recognition of a foreign insolvency proceeding and the cooperation between administrations would not involve improper prejudice to local domestic creditors. In summary, the Model Law contemplates that a domestic insolvency proceedings can take place (although its effects would be limited to the assets of the debtor in the local domestic jurisdiction) and that the interests of domestic creditors and the debtor must be

"adequately protected" in any recognition of a foreign insolvency proceeding. With those protections built into the Model Law, Canadian creditors in a multinational insolvency or reorganization would appear to be properly and equitably treated and would probably have a better position as creditors than some recent Court decisions have allowed.

Most of the major concepts in the UNCITRAL Model Law were actually adopted by Parliament in the 1997 amendments to the BIA and the CCAA. Canada in fact adopted the version of the Model Law that current at the time of the 1997 amendments. The development of the Model Law was not completed until shortly after the 1997 amendments were approved. In essence, Canada was the first country to formally legislate the principal concepts of the Model Law into its own domestic legislation.

### Canadian Participation in the Development of the Model Law

Canada was one of the most prominent countries involved in the development of the UNCITRAL Model Law. Canada was represented by an Official Delegation throughout the UNCITRAL meetings that led to the Model Law. Representatives of the Canadian insolvency judiciary took an active part in the UNCITRAL process and were prominent in the work on the Model Law. Canadian professionals were prominent with national and international associations which participated as NGOs ("Non-Governmental Organizations") during the process. The most prominent achievement of Canadian participation in the UNCITRAL process was that a Canadian lawyer, Kathryn Sabo, from the Department of Justice in Ottawa, was elected as Chair of the UNCITRAL Working Group that developed the Model Law.

Canadian participation has continued in UNCITRAL's subsequent insolvency project, the development of a Legislative Guide on Insolvency (discussed in more detail, infra.) Canada has been represented by an Official Delegation at each of UNCITRAL's meetings that have been held to consider the "best practices" which should be incorporated in a model insolvency system. Many of the concepts that are covered in these submissions and which are being discussed in the current round of BIA/CCAA reform have in fact been dealt with by UNCITRAL during the course of its deliberations on its Legislative Guide on Insolvency. The Government of Canada, through its Official Delegation to UNCITRAL, has participated in the development of the concepts that are being incorporated into the UNCITRAL Legislative Guide on Insolvency.

### Adoption of the Model Law by Other Countries

In May, 2000, Mexico became the first major economy in the world to officially adopt the UNCITRAL Model Law on Cross-Border Insolvency as part of its domestic insolvency legislation. An unofficial translation of the provisions of the Mexican Statute adopting the Model Law is included in the CD-ROM accompanying these submissions and is also available on the International Insolvency Institute website at *http://www.iiiglobal.org/country/mexico/bankruptcy.pdf*.

In November, 2000, the Parliament of South Africa passed legislation to enact the UNCITRAL Model Law. A copy of the South African statute adopting the Model Law is included in the CD-ROM accompanying these submissions and is also available on the International Insolvency Institute website at *http://www.iiiglobal.org/country/southafrica/sa_crossborder_act.pdf*. The South African statute, however, has not yet been proclaimed in force.

Japan adopted legislation in April 2001 which imported the principles of the Model Law into Japanese domestic legislation. Prior to the adoption of Japan's Law on Recognition of and Assistance in Foreign Insolvency Proceedings, the Japanese system for insolvencies had been highly territorial and Japan neither recognized foreign insolvency proceedings nor sought to extend the effect of its own domestic insolvency proceedings to property of a Japanese debtor abroad. Consequently, the adoption of the new legislation represented a very significant and very important change in Japanese insolvency legislation brought about by the adoption of the principles of the Model Law. An unofficial translation of the provisions of the Japanese Statute adopting the Model Law is included in the CD-ROM accompanying these submissions and is also available on the International Insolvency Institute website at *http://www.iiiglobal.org/country/japan/translation.pdf*.

In 2002, a very prominent panel of distinguished experts in Argentina developed a Cross-Border Insolvency Act which will incorporate the UNCITRAL Model Law into domestic Argentine legislation. This Act is presently before the Argentine Parliament but has not been passed yet as a result of the continuing domestic financial crises in Argentina. An unofficial translation of the provisions of the Argentina Statute adopting the Model Law is included in the CD-ROM accompanying these submissions and is also available on the International Insolvency Institute website at *http://www.iiiglobal.org/country/argentina.html*.

Consideration of the adoption of the Model Law is also under way in the United Kingdom, New Zealand and Australia. The United Kingdom has in fact passed enabling legislation to provide for the ultimate adoption of the Model Law and New Zealand and Australia have both studied the

Model Law and recommended its adoption. Copies of an extract from the U.K. Insolvency Act, 2000 (the enabling legislation for adoption of the Model Law), and copies of studies on the Model Law from New Zealand and Australia are on the CD-ROM that accompanies these submissions and are available on the International Insolvency website at *www.iiiglobal.org/country/newzealand/uncitral_report.pdf* and *www.iiiglobal.org/australia/insolvency_reform.pdf*. Other countries that have formally adopted the Model Law include the Republic of Montenegro in the Federation of Serbia and Montenegro and Eritrea.

### Adoption of the Model Law by the United States

The concept behind the UNCITRAL Model Law on Cross-Border Insolvency is that it can be adapted to domestic legislation in civil law jurisdictions as well as in common law jurisdictions. The United States was the first major jurisdiction to produce legislation adopting the provisions of the UNCITRAL Model Law. The UNCITRAL Model Law formed a part of the bankruptcy bills that were introduced in both the U.S. House of Representatives and Senate in 1998. The Model Law is contained in the current U.S. Bankruptcy Bill which was passed by the House of Representatives on March 19, 2003 where it forms a prospective new Chapter 15 under the title “Ancillary and Other Cross-Border Cases”.

The proposed U.S. Chapter 15 follows very closely the format of the UNCITRAL Model Law. This was a deliberate policy decision on the part of the drafters of the legislation. It was felt that if the United States enacted the Model Law in its original form, it would be a good example to other countries. The new international insolvency Chapter has proved to be non-controversial (although issues were raised with regard to its potential applicability to insurance cases) and it is very likely be enacted as part of the bankruptcy legislation currently pending in Congress. The proposed Chapter 15 (Bill H.R. 975) is included with the CD-ROM that accompanies these submissions and is available at *www.iiiglobal.org/country/usa/chapter_15.pdf* on the International Insolvency Institute Website.

From an international perspective, the adoption of the UNCITRAL Model Law on Cross-Border Insolvency in the United States will be a significant improvement to U.S. legislation over the current overly-discretional provisions which are in Section 304 of the United States Bankruptcy Code. The new Chapter 15 follows the Model Law and mandates recognition of insolvency proceedings that are taken in the debtor’s “centre of main interests”. The phrase “centre of main interests” is intended to identify where the executive functions of a company are carried out, i.e., its corporate head office.

The structure established by the UNCITRAL Model Law and, consequently, the new Chapter 15 of the United States Bankruptcy Code is essentially that primacy will be given to reorganizational insolvency proceedings that are taken in the country of the debtor's "centre of main interests" and that proceedings in other jurisdictions will be treated as "secondary proceedings" that deal only with assets and creditors in the "secondary" jurisdiction.

Under the test of a debtor's "centre of main interests", the primary jurisdiction for the proceedings for Canadian companies would be Canada and, under the prospective new Chapter 15 of the United States Bankruptcy Code, United States courts would recognize the primacy of the Canadian proceedings taken by those companies.

## Conclusion

The UNCITRAL Model Law has developed a wide international acceptance and seems certain to be adopted by virtually all of Canada's major trading partners. The adoption by Canada of the Model Law would probably fortify the ability of Canadian creditors to be able to deal with insolvencies and reorganizations of Canadian businesses in Canada because the Model Law recognizes and facilitates the Concurrent Proceedings model for multinational reorganizations and insolvencies. The adoption of the Model Law, therefore, might, in addition to its other advantages, stem the developing trend toward Canadian Courts exporting the administration of Canadian insolvencies and reorganizations to the United States.

The valuable suggestion has been made by The Insolvency Institute of Canada that the recognition of a foreign representative under the Model Law be conditioned by the contemporaneous appointment of a Canadian creditors committee to safeguard the interests of Canadian creditors in a multinational reorganization or insolvency and this concept has considerable merit. There is also an issue as to whether the Model Law should be adopted such that it would only be applicable to recognize and co-operate with proceedings from other countries which themselves have adopted the Model Law. This would seem, on its face, to be a step backward because the current international insolvency provisions of the BIA and the CCAA do not require reciprocity nor do the American and Mexican adaptations of the Model Law. Some jurisdictions may adopt the Model Law with a reciprocity requirement but there should be no need in the circumstances for Canada to do so.

## INTERNATIONAL POLICY CONTRASTS TO THE CANADIAN REORGANIZATION SYSTEM

Internationally, Canada should not have a system for reorganizations and insolvencies that is markedly less effective and attractive than those of its major trading partners. In the global economy, Canada and its commerce will be affected negatively if Canadian insolvency and reorganization systems, as part of Canada's major economic framework legislation, are less favourable and less effective than those of its major trading partners. In Canada's case, the integration of the North American economies under NAFTA and the proximity of a well-developed insolvency and reorganization system in the United States invariably means that the most direct and immediate contrast to Canadian reorganization procedures is with the United States.

If, as seems likely, the Concurrent Proceedings model for international cases that is already enshrined in the BIA and CCAA can be modified to be effective and to ensure the interests of domestic Canadian creditors are safe from prejudice or dilution, there is still a prospect that Canadian companies will continue to seek protection from their creditors in the United States either voluntarily as a means of protecting their own interests or involuntarily at the suggestion or persuasion of their major creditors. A full analysis of the important aspects of Canadian reorganizational practice must, as a consequence, also focus on the policy contrasts between Canadian and United States systems for reorganizations to determine the relative attractiveness of the United States system over the Canadian system for reorganizing companies. Recently, the United States system has attracted the reorganizations of several major Canadian corporations which have tended to emerge from bankruptcy protection in the United States as U.S. companies with U.S. head offices and U.S. infrastructures.

It should be possible by amendments to the BIA and the CCAA to create a system that would level the playing field between Canadian and United States reorganizational systems and, conceivably, make Canada at least as attractive for reorganizations and restructurings as the United States. As noted above, this task is likely to be made easier by the adoption in the United States of the UNCITRAL Model Law. Upon the adoption of the new Chapter 15, the law of the United States will be that cooperation and recognition will be required from United States courts in the case of reorganizations that are taking place in the "centre of main interests" of the reorganizing business, i.e., where its head office and executive functions are performed. Consequently, the issue in Canadian insolvency reform is to analyze the factors that have recently prompted

major Canadian companies to proceed with their financial reorganizations in the United States.

### Securities-Based Claims

In several recent high-profile Canadian cases, most notably *Philip Services*, *Loewen* and *Laidlaw*, securities-related claims may have been the single most decisive factor in leading toward the filing of a reorganizational proceeding in the United States. Under the United States Bankruptcy Code, claims for, among other things, the purchase or sale of securities are subordinated to all claims of ordinary creditors: Section 510(b) of the United States Bankruptcy Code. As a consequence, plaintiffs holding claims for substantial amounts of monetary damages based on securities-related issues are treated at the level of the shares that they hold. In a United States bankruptcy case, it is not possible for a shareholder to achieve a higher ranking claim through the simple artifice of commencing proceedings for monetary damages. In other words, a shareholder-related claim stays at the level of the shares of the company to which it relates.

Canadian practice has conventionally allowed securities-related claims to rank as ordinary unsecured claims in a reorganization. In practice, securities-related claims are generally filed on the most improbably optimistic basis available with the result that they are often very significant portions of the claims filed in a reorganization and are occasionally large enough to block a successful reorganization that is considered desirable by ordinary unsecured creditors. While claims of this kind, in the fullness of time, could be litigated and their actual value established to be much less than the amounts in which they were filed, reorganizations are very time-sensitive. Issues relating to the quantum of securities-related claims must therefore be determined as quickly as possible but it is not usually possible to do so in the abbreviated time frames that are applicable in reorganizations. Often, the time available for a reorganization is not sufficient to permit a full litigation-scale assessment and valuation of the claims involved and Canadian reorganizations are very susceptible to failure as a result of shareholder claims being elevated into creditor claims.

There are signs developing that courts in Canada may recognize the appropriateness of ensuring that securities-related claims do not, by virtue of a reorganization, elevate themselves into claims that are treated equivalently to claims of ordinary creditors. The subordination of securities-related claims has been recognized in at least two Canadian cases to this point: *National Bank v. Merit Energy Limited* (2001) 28 C.B.R. (4$^{th}$) 228, affirmed [2002] 3 W.W.R. 215 (Alta. C.A.) and *Re Blue Range Resources Limited,* (2000) 15 C.B.R. (4$^{th}$) 169 (Alta. Q.B.).

### Stays of Proceedings

One of the factors that has proved to be influential in Canadian companies choosing to file under Chapter 11 of the United States Bankruptcy Code is the extent of the protection given to reorganizing companies while they attempt to reorganize. Under both the BIA and CCAA, the initial period of protection granted to a reorganizing business is only 30 days. This is to be contrasted with practice under Chapter 11 where a reorganizing business is given a minimum period of 120 days and most cases usually involve much longer periods of protection.

It is true in Canada that there have been CCAA cases that have extended for several months, but a CCAA case that continues for over a year is a rarity in Canadian practice whereas it is commonplace in the United States. The stay of proceedings in reorganizations is intended to provide a period of stability for a reorganizing company to plan and negotiate a compromise of its liabilities with its creditors. The shorter this period of stability is, the less likely it is that creditors will be motivated to negotiate a compromise of their claims. If the period of protection were the only variable in a choice of which jurisdiction in which to file, almost all reorganizing debtors would invariably select the United States.

From the perspective of a reorganizing business, a further advantage of the protection under Chapter 11 is that it is automatic (i.e., it does not depend upon a Court Order) and that it is worldwide in scope and binds all creditors that are subject to the jurisdiction of United States Bankruptcy Court system. In that regard, the automatic stay under Chapter 11 will also apply to major Canadian-based creditors because most major Canadian-based creditors have operations or a physical presence in the United States that makes them subject to the jurisdiction of the United States Bankruptcy Court system. Paradoxically, a reorganizing business in Canada will often be able to achieve greater protection from its creditors by going to the United States than by filing under either the BIA or the CCAA.

### Scope of Stability during Reorganizations

There are other stability-related distinctions between Canadian and U.S. practice. In the BIA, a reorganizing company can be placed in bankruptcy even before its creditors vote on its proposal. Failure to file cash flow statements within the time permitted under the BIA results in an automatic bankruptcy as does a negative vote by the creditors. In addition, the BIA contains provisions under which creditors are specifically enabled to apply to the court for an Order that a proposal has been “deemed to have been rejected” by creditors even prior to the

creditors having the opportunity to vote on the proposal: Section 50(12). In the CCAA, a negative vote by creditors will almost always prompt the court to appoint a receiver to sell the assets of the company. The prospects for the "death and dismemberment" of a business for having failed in a single opportunity to gain the support of a super-majority of its creditors again operates as a disincentive for businesses in financial difficulty to seek creditor protection in Canada.

This disincentive is, again, in stark contrast with United States practice. In the United States, where the court or the creditors are not satisfied with the course of a reorganization, the court can remove the statutory protection from creditors that has been given to the reorganizing business, i.e., by dismissing the reorganization proceedings. This is usually a sufficient incentive to prompt reorganizing businesses to make diligent efforts to come up with arrangements that will be satisfactory to their creditors and stakeholders. The Canadian position almost seems to be based on the view that the companies that need to reorganize their financial affairs are somehow dishonest and untrustworthy and that, as a grudging legislative concession, they will be permitted one attempt to satisfy their creditors but if that attempt fails, they will be placed in liquidation. This view of financial restructurings is clearly no longer appropriate, if it ever was, and it would be sufficient incentive to businesses to reorganize in a good faith and a *bona fide* fashion if they were faced simply with the prospect that their protection from creditors would be taken away if they did not.

Particularly in cases of secured claims, Canadian and United States practices have another major difference. In United States, upon a filing under Chapter 11, the reorganizing company is given the responsibilities of being a trustee within the meaning of the Bankruptcy Code. The reorganization then applies to *all* claims against the "old company" (i.e., the company and its assets and business as they were prior to the filing) so that secured creditors are included in the reorganization. This has another advantage to reorganizing companies in that in the United States security granted by the company prior to its filing ("pre-petition security") does not apply to collateral created after the filing. This is in contrast to Canadian practice in which pre-existing security continues to apply to the debtor after its filing and continues to apply to assets produced after the debtor's filing and during the course of the reorganization. In the United States, this separation of assets of the business into "pre-petition" assets that are subject to the reorganization and "post-petition" assets which are not, is of assistance to reorganizing businesses in that it facilitates the debtor-in-possession financing that is usually of considerable assistance in reorganizations and which occasionally is crucial to the success of a prospective reorganization. The contrast, in other words, is that in Canada post-filing assets are "owned" by the secured creditors of the business unless such creditors

are over-secured whereas in the United States post-petition assets are "owned" by the reorganizing business and are available to assist in the restructuring.

### Availability of Creditor Protection

The United States system is said to permit greater opportunities for a financially-troubled company to reorganize. Another principal distinction between U.S. and Canadian practice is that United States practice does not require that a debtor be insolvent in order to seek protection from its creditors whereas in Canada under both the BIA and the CCAA a reorganizing business must be legally insolvent before it can seek to reorganize under protection from its creditors. In Canada, consequently, a reorganizing business that is on the verge of or anticipates going into insolvency is unable to do so until its liabilities clearly exceed its assets, i.e., it is prevented from commencing a restructuring with its creditors until much later in its financial predicament than would be the case in the United States.

As between the BIA and the CCAA, the BIA has the advantage that protection from creditors is granted on a relatively simple, straightforward document filing. This corresponds with practice in the United States. Under the CCAA, Canadian practice has retained the requirement for court approval for a business to begin a reorganization. In point of fact, few CCAA filings are rejected on a debtor's initial application under the CCAA. The amendments to the CCAA in 1997 limited the initial period of creditor protection to 30 days on the basis that this would provide a reorganizing debtor with an opportunity to obtain protection expediently and then work out the details subsequently in a further application toward the end of the initial 30 day period of protection.

This has not worked as it was intended. In Canada, the initial filing often unleashes a wave of applications to the court for relief from the stay of proceedings, for protection or exclusion of creditors from the process (by way of a "carve out" from the reorganization of particular assets or collateral) and for other incidental objectives sought by individual creditors for their own purposes. The initial 30 day period in a CCAA filing is consequently often consumed in court applications rather than in negotiations on the kind of longer-term standstill that would facilitate negotiations between the reorganizing business and its creditors.

From a logical point of view, if a business has determined that its present or future prospects are so sufficiently limited that it must embark upon a formal financial restructuring, the requirement of insolvency before the process can begin operates directly against achieving the

best result for the stakeholders. In other words, a business wishing to reorganize and revive its financial condition cannot do so prior to its liabilities exceeding its assets. If a business is in a position where a financial restructuring is foreseeable and desirable from the point of view of the business and its stakeholders, it seems to make little sense to require the company to wait until its financial condition has completely deteriorated before it can begin a formal restructuring process.

The answer might be to allow a company that is reasonably anticipating its own insolvency or inability to meet its obligations generally as they become due to be able to utilize formal restructuring procedures in the BIA or the CCAA. The perceived deficiency with this approach is that it might be said to encourage filings by improperly-motivated businesses seeking only to cease paying their liabilities. This potential criticism is probably unjustified because it is unlikely that reorganizing businesses would seek to "abuse" the insolvency system by placing their operations under the control and supervision of the court. The incentive in a reorganization system should be to persuade companies with financial difficulties to acknowledge their difficulties and move towards solving them as early as possible. If there is a need to guard against improperly-motivated businesses seeking protection from their creditors, provisions are already included in both the BIA and the CCAA that allow the court to set aside the protection obtained by a reorganizing business if the protection was sought for improper purposes.

### Creditor Representation and Participation

Another advantage that is claimed for the U.S. system is that the processes in a U.S. reorganization are more transparent than in Canada in that creditors have much greater opportunities to participate in the restructuring process and to have a voice in the direction of the reorganization. The primary vehicle through which this claimed transparency and participativeness takes place are the Creditors' Committees that are required in U.S. reorganizations.

In a U.S. Chapter 11 case, an Official Committee of Unsecured Creditors is invariably appointed and other Committees are often appointed if differing or distinct constituencies require separate representation in the reorganization process. The appointment and remuneration of these Committees and their professional advisors are under the supervision and control of the Bankruptcy Court. Creditors' Committees usually have the authority to retain their own professional advisors and are able to participate in proceedings in the reorganization. Creditors' Committees and their advisors are remunerated from the assets under administration (which tend to be the post-petition assets which are, as noted above, free of the claims of pre-petition secured creditors, absent any order to

the contrary from the Bankruptcy Court). Creditors' Committees are the means by which the input from the general body of creditors of a reorganizing business can be focused on the debtor and its prospective Plan of Reorganization during the course of the company's reorganization proceedings.

The contrast with Canadian practice, again, is very stark. The BIA mandates a Board of Inspectors in liquidations but not in reorganizations. Inspectors can be appointed in reorganizations but only if the reorganizing debtor makes the appointment of inspectors part of its proposal. In liquidations, the powers of inspectors are largely of an advisory nature although the permission of the inspectors is usually required for administrative actions that are outside the ordinary course of business. In proposals, the extent of the power of inspectors will vary but the tendency in practice is for proposals to provide only consultative roles for inspectors and to provide inspectors with no real means of influencing or guiding the negotiations toward a successful proposal. In the CCAA, there is no provision of any kind for the appointment of a Creditors' Committee and, in some recent cases, courts have refused to appoint Creditors' Committees, ostensibly on the basis of concerns over the expense that a Creditors' Committee would entail.

Consequently, the transparency responsibility in a major CCAA reorganization devolves upon the Monitor. Monitors in CCAA proceedings, however, have only rudimentary responsibilities to report to creditors and, although practice seems to vary from province to province, the preponderance of Canadian experience seems to be that Monitors do not regard themselves as being under an obligation to consult creditors nor to keep creditors informed of the progress of negotiations except through filing reports in support of whatever action the reorganizing business has determined, with the participation and assistance of the Monitor, is appropriate in the circumstances. If Monitors were independent and actually represented the interests of unsecured creditors, the transparency and participativeness of the CCAA would dramatically increase but, as noted below, the position of Monitors in CCAA reorganizations attracts a variety of conflicting interests and responsibilities which can seriously divide and compromise Monitors' interests, duties, responsibilities and loyalties.

### Independence and Accountability of Insolvency Officeholders

A developing concern for reorganizing businesses that have the choice of reorganizing in the United States or in Canada revolves around the different standards that are applicable to insolvency officeholders. In the United States, insolvency officeholders and professional advisors to reorganizing business must be "disinterested" from the business in order

to serve in a reorganization. This test is much higher than simply the avoidance of a conflict of interest. The theory is that insolvency officeholders and professionals involved in the case must come to it with an independent and an objective view and must not be subject to the views or influences of other clients or other professional involvements. In essence, the U.S. position is not very far removed from the "duty of loyalty" owed by professionals in representative positions to those whose interests they represent which has recently been confirmed, for lawyers, by the Supreme Court of Canada in *Regina v. Neil,* (2002) 6 Alta. L.R. ($4^{th}$) 1 (S.C.C.). The "disinterestedness" test in the United States is enforced by the possibility of sanctions. The most often-utilized sanction for insolvency professionals who have contravened the disinterestedness test is the "disgorgement" (i.e., repayment) of fees paid for their services although there are examples of punitive sanctions being imposed as well.

By way of contrast in Canada, even conflict of interest rules may not be applicable. There are very limited rules in the BIA as to the requirements of professional independence. Most of these rules revolve around the ability of a trustee in bankruptcy to act for a secured creditor at the same time, a situation that would be impossible in the United States. The Canadian legislative answer to that problem is to permit this dual representation to continue provided (i) that the trustee obtains an opinion from a lawyer (who need not be independent of the secured creditor except in the case itself) that the security held by the secured creditor is valid and (ii) that the trustee makes disclosure to the creditors that it has a multiple representation. It is important to note that a trustee in these circumstances need not obtain the consent of the creditors to act notwithstanding that it has had or continues with a different representation: it is sufficient to simply disclose that it has the other representation. Again, this is a situation which the United States Bankruptcy Code does not permit.

In Canada, the most obvious and inexplicable example of conflict of interest in insolvency proceedings is the ability of the auditor of a reorganizing company to act as its Court-appointed Monitor in a CCAA proceeding. Auditors, of course, are prohibited by the BIA from acting as trustees in BIA reorganizations for a period of two years subsequent to ceasing to serve as the company's auditors. In the CCAA, however, the ability of auditors to serve in this explicit situation of conflict of interest has been statutorily enshrined. Prior to the amendment of the CCAA to permit auditors to serve as Monitors, there had been cases in which the courts had disqualified auditors from acting as Monitors because of the obvious conflict of interest involved but the practice was made permissible in the 1992 amendments to the CCAA: Section 11.7(2).

The standards of independence applicable in insolvency cases have deteriorated even further since that point. There have been examples in major cases where the auditors of a company have served as its Monitor during a CCAA proceeding and then served as its Receiver on behalf of the company's secured creditors when the CCAA proceedings were terminated and as its Trustee in Bankruptcy on behalf of unsecured creditors during an accompanying bankruptcy. Canada should be able to devise a standard of independence that would ensure the representatives of creditors in insolvency cases are free from other interests and other relationships that might impact on their objectivity and their ability to serve the creditors they are appointed to represent.

For a Canadian business faced with the prospect of reorganizing, the United States system provides more transparency and is much freer from conflicts of interests than the Canadian system. By itself, this consideration would not be determinative in selecting the jurisdiction in which to reorganize but in conjunction with the number of other factors which also favour the United States, this consideration could be influential in guiding reorganizing business to seek reorganizational protection in the United States.

### A Specialized Insolvency Judiciary

Another issue of concern is often expressed as the lack of a broadly-based judicial experience that is specifically dedicated to deal with bankruptcies and reorganizations. There are, in Canada, a very limited number of judges with significant specialized experience in bankruptcy and insolvency matters. Even in the main Canadian commercial centres of Toronto, Montreal, Vancouver and Calgary, if even two experienced judges were unavailable for any reason, the level of expertise to deal with the complex bankruptcy and insolvency matters would drop dramatically.

By contrast, the United States has a full-time dedicated Bankruptcy Court bench. Every Bankruptcy Court Judge is a specialist in bankruptcy matters and hears primarily, if not exclusively, bankruptcy issues and cases. Because of their shared specialization, Bankruptcy Court judges in the United States have formed active professional organizations and associations. These organizations have established and publish periodicals and journals of comment and analysis and hold conferences that deal with bankruptcy issues and topics. This establishes and reinforces an expertise in bankruptcies and reorganizations at a very elevated level which is almost entirely absent, for structural reasons, in the Canadian judiciary.

In Canada, bankruptcy functions are performed by judges who are designated for that task by the Chief Justice of the Province: BIA, Section 185(1). Under this provision, the Chief Justice is authorized but not required to nominate judges to exercise the powers conferred by the BIA. Canadian judges in bankruptcy cases are Superior Court Judges and their responsibilities include the entire range of issues that come before Canadian Superior Courts. U.S. creditors are almost always apprehensive concerning the prospect of complex cases going before judges whose primary experience and main fields of interest can quite easily be in areas that are highly remote from the specialized issues in reorganizations, particularly international reorganizations. It is beyond the pale of U.S. experience that a complex reorganization would be guided or even affected by a judge whose primary interest might be in criminal, administrative or, even, family law.

There has been a developing recognition among the judiciary and the insolvency profession that a greater degree of specialization in administering bankruptcies and reorganizations would be beneficial both in enhancing the interests of stakeholders in reorganizations and in furthering the Canadian public interest in having an experienced, understandable and predictable system for reorganizations and restructurings. This recognition is expressed in the development in Toronto and Montreal of a “Commercial List” system which is intended to develop a group of judges with specialized insolvency experience. Informal, less structured, allocation of judicial resources has developed to a degree in Calgary and Vancouver as well. The drawback to these informal initiatives is that they have only an informal basis for their operations and that attractiveness of a posting to these judicial responsibilities has proved so high (at least in Toronto) that, with a limited number of exceptions, there is a very high turnover of judges who take part in the process. The requisite broad judicial experience in complex cases has consequently not developed in the intended fashion.

The development of a specialized insolvency judiciary with experience and capability in complex cases, particularly international cases, can probably not be achieved under the existing system of having Provincial Chief Justices designate the judges to deal with bankruptcy matters. There appear to be no published standards and no published criteria for the designation of a particular judge to be a bankruptcy and reorganization specialist. This is antithetical to the development of a bankruptcy judiciary with experience and capability in these complex issues.

The evolution of a specialized bankruptcy and restructuring judiciary could be brought about by quite modest changes. The responsibility for designating bankruptcy and insolvency judges could be given to the Governor-General in Council through minor amendments to the BIA and

the CCAA. The designation could be made for a limited term which could be certainly made renewable. The designation could be made on the recommendation of the Chief Justice but the process should also add some transparency so that input would be available from the specialized associations and professionals who regularly deal in matters governed by the BIA and the CCAA.

## THE DEVELOPING CO-OPERATION IN CROSS-BORDER REORGANIZATIONS

With the growing integration of North American economies brought about by NAFTA and with increased globalization generally, cross-border reorganizations and insolvencies are becoming more common than ever before. A dozen years ago it was reasonably uncommon to find a case with an international or cross-border aspect but, these days, it is unusual to find a major reorganization or insolvency that does *not* have international or cross-border aspects. The increased frequency of cross-border and international cases has not, however, seen a corresponding improvement in the means by which international insolvencies and reorganizations are dealt with. Consequently, improvements in this area seem destined to be derived primarily from the cooperation of the insolvency community in different countries. Because of the void in international treaties and conventions, the insolvency community has had both the obligation and, as well, the opportunity to achieve advances in the current international regime for dealing with cross-border insolvencies and reorganizations.

### The International Bar Association Cross-Border Insolvency Concordat*:*

One of the most significant initiatives in improving the framework for cross-border insolvencies emanated from the Insolvency and Creditors' Rights Committee of the Section on Business Law of the International Bar Association (Committee "J" in IBA parlance). The International Bar Association is the world's largest international organization of law societies, bar associations and individual lawyers engaged in multinational legal issues. Committee J is one of the major Committees of the IBA's Section on Business Law with a membership of 1,100 insolvency and creditors' rights lawyers from over 80 countries worldwide.

Committee J's major initiative was its Cross-Border Insolvency Concordat which was formally adopted by the Council of the Section on Business Law of the International Bar Association at its Twelfth Biennial Meeting in Paris in September, 1995 and by the Council of the International Bar Association itself at the IBA Council meeting in Madrid in May, 1996.

The Cross-Border Insolvency Concordat is intended to suggest rules applicable to cross-border insolvencies and reorganizations which the parties or the courts could adopt as practical solutions to cross-border issues arising in proceedings in different countries. The Concordat is

based on the view that an insolvency regime which is predictable, fair and convenient can promote international trade and commerce. International commerce can clearly be enhanced and facilitated by an international understanding that particular principles or guidelines are available in the event of a business failure or reorganization. The Concordat is intended to focus the experience of the insolvency community to develop guidelines which could be used in identifying solutions to individual cross-border insolvencies.

In developing the Cross-Border Insolvency Concordat, Committee J established country teams in over twenty-five of Committee J's member countries and these teams reviewed the Concordat from the point of view of their domestic law and practice to ensure that its principles would be acceptable to the domestic courts in their countries. The process was inestimably assisted by the active participation of distinguished judges from several different countries including Canada, the United States, South Africa, Japan, France, England, and Denmark.

### Cross-Border Insolvency Protocols*:*

The example of the IBA's Cross-Border Insolvency Concordat has led to an increasing trend toward the development and use of Protocols in cross-border cases. These Protocols have been developed on an *ad hoc* basis by the courts and practitioners as a way of dealing with the legal and practical issues relating to businesses that have assets in different jurisdictions. Cross-Border Insolvency Protocols have been successfully used in a growing number of recent cross-border cases.

The development and use of Cross-Border Insolvency Protocols was accelerated by the IBA's Cross-Border Insolvency Concordat. The leading case to apply the Concordat was a two-country reorganization between Canada and the United States involving a company called *Everfresh Beverages Inc. Everfresh* was a Delaware company with its head office in Chicago and with operations in Illinois, Michigan and Ontario. When it encountered financial difficulty, it filed a BIA Notice of Intention to Make a Proposal in Toronto and concurrently filed under Chapter 11 in the United States Bankruptcy Court in New York.

The company and its creditors promptly developed a Cross-Border Insolvency Protocol based on the IBA's Cross-Border Insolvency Concordat. The Cross-Border Insolvency Protocol set up procedures to deal with such things as the administration of assets in both countries, the sale of assets in both countries, the distribution of the proceeds of sales and coordination in classifying and dealing with creditors' claims.

In a remarkable example of international comity and cooperation, the Cross-Border Insolvency Protocol in the *Everfresh* case was approved

by the Canadian Court and the U.S. Court on the same day. The adoption of the Cross-Border Insolvency Protocol in the *Everfresh* case dramatically reduced the number of issues that might otherwise have arisen and it put the emphasis in the *Everfresh* reorganization on the commercial and reorganizational aspects of the case rather than on the more obscure conflicts of law issues that might otherwise have been litigated at some length and with considerable delay and expense. (*Re Everfresh Beverages Inc.:* United States Bankruptcy Court for the Southern District of New York (Case No. 95 B 45405) and Ontario Superior Court of Justice, Toronto (Case No. 32-077978).

Subsequent to the Cross-Border Insolvency Protocol in *Everfresh*, the practice of Protocols in international cases has grown and expanded. The unofficial listing maintained by the International Insolvency Institute indicates that there are now over 20 cases in which Cross-Border Insolvency Protocols have been entered into in international cases. A listing of the major Cross-Border Insolvency Protocols that have been entered into between courts in different countries is included with the CD-ROM that accompanies these submissions and is available on the International Insolvency Institute website at *www.iiiglobal.org/international/protocols.html.*

## *THE UNCITRAL* LEGISLATIVE GUIDE ON INSOLVENCY

Following the conclusion of its very successful project on developing the Model Law on Cross-Border Insolvency, UNCITRAL, acting on a suggestion from Australia, began work on its *Legislative Guide on Insolvency.* The concept behind the *Legislative Guide* is to develop an international consensus around a set of principles for insolvency legislation that would reflect an international consensus on "best practices" for those principles. Delegations from over 60 countries thus far have participated in the development of the UNCITRAL *Legislative Guide* including an Official Delegation from the Government of Canada. The International Insolvency Institute has also actively participated throughout the development of the *Legislative Guide*.

The *Legislative Guide* is nearing its conclusion and is expected to be approved by the Council of UNCITRAL at its Plenary Session in New York in June 2003. Upon its approval by the Council of UNCITRAL, it will proceed in the normal course to be placed before the General Assembly of the United Nations for the final United Nations approval. At that point, the *Legislative Guide* will be an officially-adopted template for model insolvency legislation. In fact, UNCITRAL's experience is that a number of countries that are currently considering the reform of their insolvency legislation already have taken into account the recommendations that emerged during the development of the *Legislative Guide.*

For Canadian legislative purposes, the *Legislative Guide* can also serve as a constructive model for consideration because of the enormous breadth of international input and experience that went into its development. A number of issues that are current and contemporary issues in domestic insolvency law and policy have been dealt with in the UNICITRAL *Legislative Guide.* Copies of the current text of the *Legislative Guide* are included in the CD-ROM that accompanies these submissions and are available on the International Insolvency Institute's website at *www.iiiglobal.org/organizations/index.html.*

For ease of reference, provisions relating to issues that are likely to be discussed in the context of the current round of Canadian insolvency reform can be reviewed in the *Legislative Guide* as follows:

| **Recommendation No.'s.** | **Legislative provision** |
|---|---|
| 82-94 | Stays during reorganization |
| 118-132 | Treatment of existing contracts in insolvency |
| 136-147 | Rejection of contracts in insolvency |
| 151-167 | Avoidance actions |
| 206-217 | Business operations during reorganization |
| 233-238 | Qualifications of insolvency representatives |
| 276-288 | Creditors' committees |
| 309-317 | Preparation of reorganization plans |
| 361-375 | Expedited reorganization procedures |
| 412-420 | Reorganization (D.I.P.) financing |

It is important to recall the important and prominent role that Canada played in the development of the *Legislative Guide* through representatives of the Department of Justice and the Department of Industry who served with great distinction in the UNCITRAL deliberations that led to the development of the *Legislative Guide.*

## SUMMARY OF CONCLUSIONS: IMPROVING THE INTERNATIONAL EFFECTIVENESS AND ATTRACTIVENESS OF THE CANADIAN REORGANIZATIONAL SYSTEM

Based on the review of the considerations described above, it is possible to identify certain specific features which could be implemented in Canadian insolvency legislation in a fashion that would be neutral to the interests of reorganizing businesses and their creditors and which would ensure that the interests of domestic Canadian creditors are given due recognition in multinational and international insolvencies and restructurings. In summary, the general conclusions that could usefully be included in our revised insolvency legislation would include, primarily, the following:

- Canada should act in concert with its major trading partners and adopt the UNCITRAL Model Law on Cross-Border Insolvency.

- Claims in insolvency proceedings relating to the issuance or holding of shares in a reorganizing business should be treated as ranking below the claims of ordinary creditors.

- Insolvency officeholders should be independent of other interests and other relationships which might influence their decisions in carrying out their responsibilities.

- Provisions for Creditors' Committees should be made in the CCAA and the powers of inspectors in the BIA (and Creditors' Committees in the CCAA) should be expanded and enlarged.

- Creditor protection under the CCAA should be available through the filing of a statutory notice rather than requiring a full-scale application to the court.

- A reorganizing business should be able to begin a financial restructuring or reorganization based on impending or anticipated insolvency or an inability to meet its obligations generally as they become due, subject to the ability of the court to dismiss proceedings that have been taken improperly.

- The initial period for stays of proceedings in BIA and CCAA reorganizations should be lengthened.

- A reorganizing business should not be placed automatically into bankruptcy for failing to observe technical statutory requirements and should not be placed in automatic bankruptcy even after an adverse vote by one or more classes of its creditors. An application to the court should be required and the court should be able to, among other things, simply remove the debtor's protection from creditors.

- Provision should be made to prevent the administration of Canadian assets from being carried out by courts in other countries in the same fashion the 1997 amendments to the BIA and the CCAA precluded courts from having the ability to direct that assets be transferred out of Canada.

- Measures should be put in place that would encourage the development of a formal insolvency specialization among the Canadian judiciary.

There is no compelling structural reason why Canada cannot have a system for reorganizations and insolvencies that recognizes and adapts to the international realities of globalization and which at the same time is fair, effective and transparent. In short, Canada could have one of the finest insolvency systems in the world. One of main reasons why it does not is the chronic lack of resources that are available for the reform and improvement of the Canadian insolvency system. This shortcoming has translated into only two piece-meal legislative reforms over the last 12 years which have not been able to address the Canadian system and its need for improvement as a whole.

If Canada does not have the resources or the inclination to study, review and assess its own system for reorganizations and restructurings to ameliorate the deficiencies that have been inherited with the present system, Canada should have the good sense to pick from the best-available concepts from the legislative system of other countries. Ideally, Canada could study, analyze and develop a system of reorganizations that would improve its current model and provide incentives for Canadian businesses to reorganize in Canada. To do so, however, Canada would have to match or improve upon concepts and systems

that are readily available across the border to Canadian businesses and this may prove difficult and may be unnecessary.

Although some may find fault with adapting various aspects of United States bankruptcy law and practice, the issue should not be framed in terms of “us” versus “them”. A number of the suggestions referred to above have already been adapted and accepted by Canadian courts in Canadian practice in Canadian cases. Subordination of shareholder claims to the claims of ordinary creditors has already been accepted at the appellate level in Canada. Equitable subordination (a U.S. concept based on 19th century English concepts of equity) is beginning to be applied in Canada and, in its equitable results, the remedy substantially resembles the “oppression remedy” powers that have been adopted in all Canadian provinces and in Federal corporate legislature.

Much of the criticism of the United States bankruptcy system overlooks the fact that it was developed through a process that involved intense professional and academic consideration, consultation and comment. Bankruptcy (with its connotations of a “fresh start”) has always been relatively more important in the United States than in the Commonwealth countries. Bankruptcy in the United States has become a major component of commercial law and practice and has attracted levels of professional, academic, judicial and legislative attention and analysis that Canadian bankruptcy and insolvency practitioners can only dream of. With so much analysis and experience with bankruptcy and reorganizational concepts and practice, it is not surprising that the United States Bankruptcy Code is extensive and complex. It may, however, also be characterized as fair, transparent and structured.

There should be no reason to refuse to consider particular reorganization concepts simply because the United States had them first. It is worth remembering that all Canadian Provinces and Territories have essentially adopted Article 9 of the United States Uniform Commercial Code for their personal property security registration systems. They did not do so because Article 9 was a U.S. invention; they did so because Article 9 represented a system that was far superior to existing Canadian systems and one which could be readily adapted to great advantage in the Canadian commercial credit system. Canada may currently be in the same position vis-a-vis bankruptcy reform as it was in the early 1970’s with regard to the reform of Canada’s personal property security systems. Canada should not resile from adopting better ways to do things simply because the United States system produced solutions Canada needs before Canada did. It should be possible for Canada to develop a system for reorganizations and restructurings that has the advantages of the pragmatic Canadian approach to resolving situations of financial difficulty as well as selected proven concepts from United States bankruptcy experience but without the structural

drawbacks and weaknesses of the U.S. system. Canada can have a system of this kind and should not shrink from the challenges and opportunities of developing it.

Respectfully submitted on behalf of
The International Insolvency Institute

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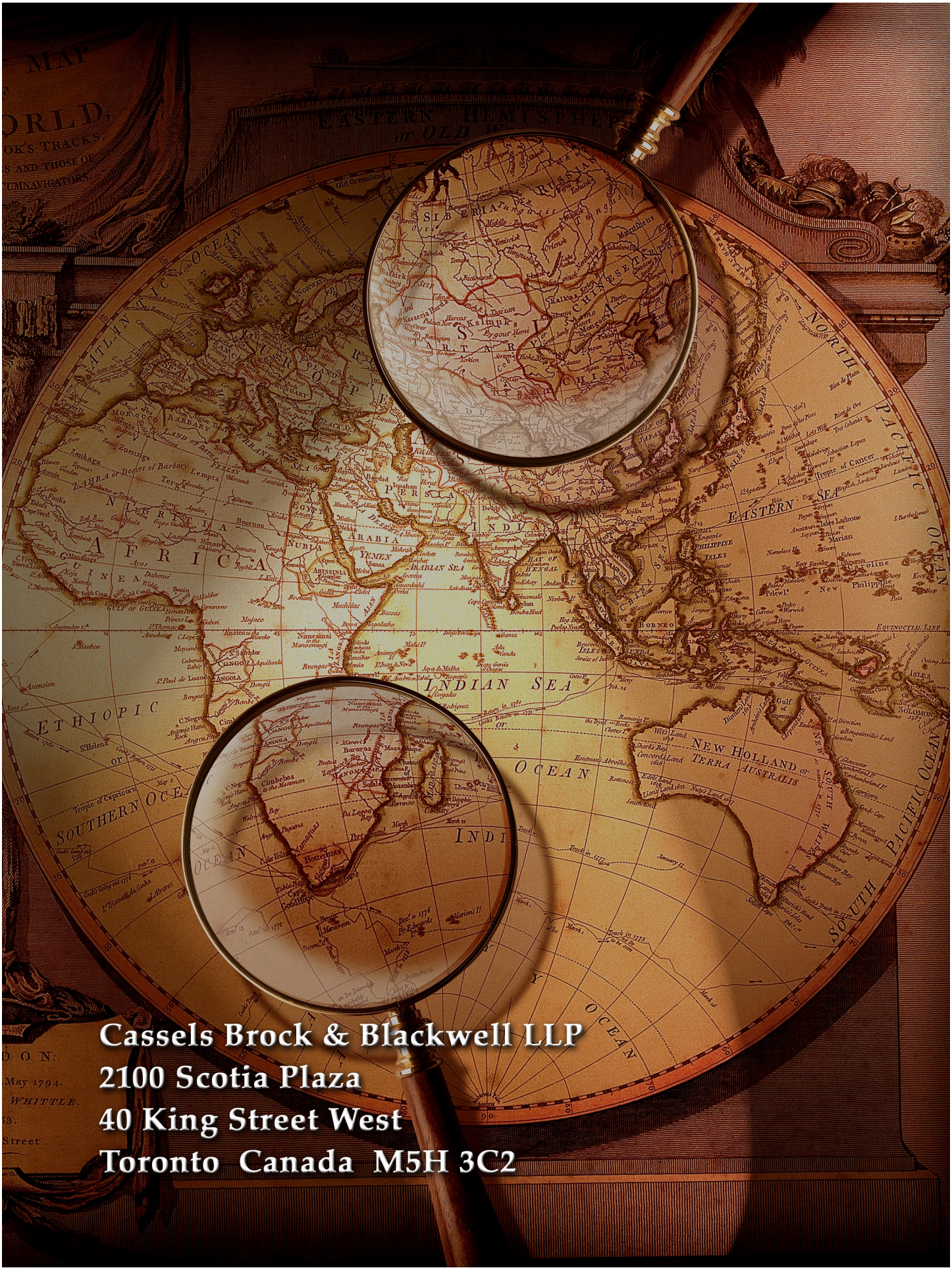
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