TAB 5

2004 ANNREVINSOLV 4

Annual Review of Insolvency Law

Editor: Janis P. Sarra

Annual Review of Insolvency Law 2004

4 — Governance and Control: the Role of Debtor-in-Possession Financing under the CCAA

Janis P. Sarra[FN1]

5. — Chief Restructuring Officers

Chief restructuring officers (CROs) are increasingly used in CCAA workouts, frequently appointed in the initial stay order. This development is a governance response to creditor concern that directors that may have skills appropriate to oversee financially healthy corporations do not have the skills or expertise to deal with a turnaround situation. The CRO is vested with responsibility to steer the insolvent firm through the negotiation for a plan and the restructuring process. CROs tend to be "turnaround experts" that take over control of the corporation, replacing most of the functions of the CEO and the directors. Algoma Steel, Loewen, and Consumers Packaging Inc. are all recent examples of CCAA cases that utilized a CRO.[FN109] The appointment of a CRO can result in higher creditor confidence, particularly where creditors attribute the firm's financial distress to failures of governance. One example is Ivaco, where creditors succeeded in replacing an officer as CRO. The CRO can also serve as a buffer between equity investors, directors, officers, and creditors, undertaking the often tough negotiations required for an effective workout. As a new participant, the CRO has all the advantages of a fresh assessment of the financial distress and the potential for refinancing and a viable workout.

Given that the CRO is a court-appointed officer, the supervision of the court can ensure a measure of accountability that is normally a function of the relationship between the corporate board and senior managers. The precise obligations of the CRO have not been yet fully considered by the courts. If the CRO is court-appointed, arguably it has obligations to the court and must act neutrally with responsibility to stakeholders. If so, CROs acquire fiduciary obligations to consider the interests of all stakeholders with an interest in the process. They also have reporting obligations to the court and have taken the benefit of D&O liability protection charges in DIP financing orders. However, another view is that the CRO's objective is to maximize the value of fixed capital claims while managing the turnaround of the company. In which case, to whom does the CRO owe obligations? It may depend on the mandate of the CRO in terms of whether to restructure internally, seek a sale of the debtor corporation to third parties as a going concern, or facilitate a liquidation outcome. These issues have not yet been canvassed before Canadian courts, leaving the issue of fiduciary obligation by CROs an open question.

Most of the CRO's compensation is performance-incentive driven: performance measured by return to creditors. Hence there is some risk that the CRO will fail to recognize or take into account the interests of all stakeholders.[FN110] Where the CRO is selected by the DIP lender, there may be a risk of the CRO deferring to the interests of the DIP lender to the detriment of other creditors' interests. Moreover, CCAA orders tend to protect the CRO from all of the usual liability that directors and officers face in

respect of workers and other claimants. Agency issues arise in terms of CRO decision making that can shift value to senior secured creditors to the disadvantage of longer term, but junior, secured or unsecured creditors. These risks are mitigated somewhat by the supervisory role of the court. However, just as the agency costs of management of the solvent firm may be a key factor in firm success or failure, the potential agency costs of CROs needs further study.

TAB 6

2006 ANNREVINSOLV 17

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Editor: Janis P. Sarra

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Annual Review of Insolvency Law 2006
17 — Practical Aspects of Governing Distressed Enterprises in Canada

17 — Practical Aspects of Governing Distressed Enterprises in Canada

William E. Aziz, Richard M. Grudzinski, and Edward A. Sellers[FN*]

I. — Introduction

Over the past quarter century, Canadian commercial practice has witnessed a shift in focus toward closer scrutiny of corporate governance matters. Although there are many factors that led to this development, the depth of the recession facing Canada in the early 1980s and the potential failure of large businesses such as Dome Petroleum Inc. surfaced debate over how and why enterprises became distressed[FN2] and by what means and under whose direction and control such enterprises should be restructured or liquidated.[FN3] To that point, when distressed businesses in Canada lost the support of their senior secured lenders, the typical result was receivership with a sale and/or liquidation of assets. However, the challenges inherent in "mega" cases such as Dome Petroleum (where it was thought the enterprise was "too big to fail" and loss of value likely occasioned by a receivership was too devastating to risk) called for the adoption and refinement of techniques to preserve value through restructuring transactions. This development was furthered in many respects through the restructuring of numerous large real estate and retail oriented enterprises throughout the 1980s and early 1990s[FN4] in a resurgence of cases under the *Companies' Creditors Arrangement Act*[FN5] (CCAA). In turn, this resurgence led to a pervasive and fundamental change in approach when dealing with distressed enterprises generally in Canada.

Parliament's adoption of substantial amendments to the *Bankruptcy and Insolvency Act*[FN6] (BIA) in 1992 extended the restructuring approach inherent in the "mega" cases to smaller enterprises with far less complex capital structures. As the possibility of effecting a restructuring became generally available through a "debtor-in-possession" approach, an entire generation of practitioners in the Canadian legal and financial communities came to view potential outcomes for distressed enterprises and the means to achieve those outcomes in a very different light. Canadian insolvency practitioners would come to learn that their ability to achieve successful restructuring outcomes through a debtor-in-possession approach was highly dependent on the governance characteristics of the enterprise. Indeed, those same governance characteristics were frequently identified as being one of the principal sources of much of the distress facing the enterprise in the first instance.

Throughout the 1990s and over the first five years of the 21st Century, Canadian insolvency practitioners en-

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gaged in a debate concerning the nature and scope of the duties owed by directors of distressed enterprises in Canada to persons and entities beyond the corporations they served.[FN7] In large measure, the debate was fuelled by two main factors: (i) experience developed through a more broadly based approach to debtor-in-possession restructurings; and (ii) the influence of U.S.-based concepts relating to fiduciary duties of directors of distressed businesses, reflecting a highly integrated North American economy and the resolution of some very complex restructurings facing distressed enterprises with substantial operations in both Canada and the United States.[FN8] Whether and to what extent directors could be said to owe duties to persons and entities other than the corporations they served became a fundamental feature in the "push-pull" and clamour for position and influence in the resolution of many of these cases.

During the same period, the nature and scope of the role fulfilled by court-appointed officers in Canadian insolvency proceedings began to change and expand, particularly in respect of monitors appointed pursuant to the provisions of the CCAA[FN9] and interim receivers appointed pursuant to the provisions of the BIA.[FN10] The expansion of the nature and scope of those duties largely occurred in response to the need for better governance in critical situations in order to preserve value in insolvent circumstances. Duties and capacities that had previously been solely within the purview of corporate directors for debtors-in-possession or full-blown receiver and manager appointments were conferred upon court-appointed monitors and interim receivers in order to achieve the most successful outcomes possible in the circumstances, notwithstanding the governance failures of the debtors.

As a corollary, the extraordinary demands placed on management occasioned by a debtor-in-possession approach frequently led to the temporary appointment of Chief Restructuring Officers (CROs) to provide the specialized management skills necessary to deal effectively with distress situations. In many cases, CRO appointments were required as a condition of continued support from key stakeholders (particularly senior lenders) to address perceived deficiencies in senior management's ability to effect a restructuring or a loss of confidence in senior management generally. Although practices varied widely, in certain large cases CRO appointments were court approved, with their duties, reporting obligations, protections, and compensation confirmed by court order. [FN11] Many CROs have been instrumental in effecting substantial improvements in governance practices during restructurings.

More recently, organizations such as The Insolvency Institute of Canada (IIC) and the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) have engaged in a consultative process to canvass the views of Canadian insolvency practitioners regarding a host of matters fundamental to the resolution of insolvency proceedings in Canada. This effort conducted through a Joint Task Force focused, in part, on numerous aspects relevant to the governance of distressed enterprises in Canadian insolvency proceedings and the roles boards of directors, supervising courts, and their independent court officers should play in the resolution of these cases. A series of recommendations from the Joint Task Force were put forward to the Government of Canada in 2002[FN12] and examined and reported on in detail by the Senate Standing Committee on Banking, Trade and Commerce in 2003 (Senate Committee Report).[FN13] Supplementary recommendations were issued by the Joint Task Force in response to the Senate Committee Report in 2005,[FN14] with the hope that legislative developments would reflect the detailed and thoughtful analysis that had gone into the recommended approach to legislative amendment.

In June 2005, what was then known as Bill C-55 was introduced in the House of Commons and styled by the Government of the day as a comprehensive approach to the amendment of Canada's insolvency legislation, including those aspects relating to corporate governance. Bill C-55 was passed by Parliament and given Royal As-

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sent in November 2005,[FN15] but has yet to be proclaimed as of the date this article was written pending further potential legislative amendments to cure what many have viewed as significant deficiencies in the legislation, including in its provisions relating to the governance of distressed enterprises in Canada.[FN16] So, it seems the debate over the appropriate approach to be taken in conjunction with the governance of distressed enterprises in Canadian insolvency proceedings has yet to be resolved.

Regardless of how that debate resolves itself or the final form in which Canada's insolvency legislation is proclaimed in force, approaches taken and techniques used to advance the governance of distressed Canadian enterprises will matter. In the pages that follow, we discuss selected practical aspects of: (a) the most significant duties to be fulfilled in meeting corporate governance challenges; (b) some of the techniques we have observed that can be of assistance in managing those challenges and meeting those duties; and (c) some of our observations on how practitioners might successfully assist or manage aspects of the governance of distressed enterprises in Canada, both in the context of the decline of a distressed enterprise and in its most critical stages.

II. — Selected Corporate Governance Challenges

As has been stated elsewhere, the governance of a Canadian enterprise in financial distress is not for the faint-hearted and involves managing duties to and the interests of the corporation, its shareholders, employees, creditors, and others.[FN17] Knowing the nature and extent of those duties and interests is not a simple task, let alone fulfilling them in distressed circumstances. A comprehensive review of directors' and officers' duties and the interests to be regarded in Canada is beyond the scope of this article. However, we offer the following observations on those directors' duties and interests, together with selected best practices that might be pursued to exercise business judgment properly in distressed circumstances.

1. — The Scope of Directors' Duties

After a series of conflicting lower court decisions in Canada on the scope of directors' fiduciary duties,[FN18] in 2005 the Supreme Court of Canada largely settled the debate in what has been colloquially referred to as the *People's Department Stores Ltd. (1992) Inc., Re* decision (*Wise*).[FN19] The questions before the court in *Wise*, on this point, related principally to the potential liability of the directors of a corporation to its creditors in having adopted and permitted the operation of a joint inventory procurement program with its wholly owned subsidiary in a manner that left an outstanding unsecured receivable owing from the subsidiary at the time insolvency proceedings engulfed both of them. Comments on the *Wise* decision have been varied and extensive, and we do not intend to put forth an exhaustive analysis here.[FN20]

Briefly put, on this point, the *Wise* decision essentially held that, in fulfilling their statutory fiduciary duty and duty of care, directors were obliged to act in the best interests of furthering a "better" corporation and owed no fiduciary duty to anyone other than the corporation in doing so, even in the proximity of insolvency. The court noted that directors are obliged to maintain confidentiality, act selflessly, avoid favouring the interests of any one particular stakeholder, and manage assets in furtherance of corporate objectives in fulfilling their fiduciary duty to the corporation. So long as directors act prudently and on an informed basis in reaching business decisions, and where those decisions accord with a "range of reasonableness" to better the corporation, decisions taken on matters free from self-interest, fraud, or dishonesty can be taken free from concerns relating to the fulfilment of a fiduciary duty. Moreover, the court essentially held that courts should defer to the proper exercise of business judgment (i) where it could be said to have been exercised by directors acting prudently and on an informed basis; and (ii) where the business judgment resulted in decisions and actions falling within a range of

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reasonableness where perfection is not demanded. That is not to say that in exercising business judgment directors are free to disregard the interests of creditors and other stakeholders. The court noted that any concerns in that regard might best be measured against the so-called "oppression remedy" standards set out in s. 241 of the *Canada Business Corporations Act* (CBCA)[FN21] and similar provincial corporate statutes.

At first blush, the essential elements of the *Wise* decision relating to governance issues appear to be fairly straightforward. However, their application in distressed circumstances can prove challenging. A recent example in complex circumstances serves to illustrate the point: the ongoing insolvency proceedings relating to Calpine Canada Energy Ltd. (the first major Canadian insolvency proceeding relating to a so-called "income trust"). A complex enterprise structure intended to achieve tax efficiency, amongst other matters, resulted in individuals serving as trustees of a so-called "income fund" (Fund) and the commercial trust owned by the Fund (Trust), which was the principal unitholder and creditor in a limited partnership (LP), while at the same time serving as directors of the general partner of the LP. Tightly structured and comprehensive administration and management agreements called for the former general partner of the LP (Calpine Canada) to administer and manage all of the affairs of the LPs, the Fund, and the Trust, exclusively. The directors of Calpine Canada also formed a minority of trustees of the Fund.

For a number of reasons, including the commencement of insolvency proceedings under the U.S. *Bankruptcy Code*[FN22] by Calpine Corporation (the indirect parent corporation of Calpine Canada), Calpine Canada commenced insolvency proceedings under the CCAA and sought court protection as well for a number of affiliates. [FN23] Two weeks prior to the commencement of the CCAA proceedings, those trustees/directors related to Calpine Corporation resigned as trustees of the Fund but remained directors of Calpine Canada and continued to direct its activities during the CCAA proceedings, which included administering and managing the Fund, the Trust, and the LP, exclusively.

The remaining trustees of the Trust applied to the court for certain declarations with respect to alleged conflicts of interest on the part of Calpine Canada as well as an interpretation of the administration and management agreements that would give the remaining trustees control over the re-tolling of Calpine Canada's energy centre — one of the principal assets of the LP. In turn, Calpine Canada applied to have the CCAA stay of proceedings enforced against the remaining trustees and to prevent them from interfering with the re-tolling process. Allegations concerning potential abuse of position and self-interest were levelled by the remaining trustees against Calpine Canada in its capacity as administrator and manager of the Trust. Each of the trustees and Calpine Canada sought approval of rival protocols with respect to the re-tolling process. Ultimately, the matter was resolved in favour of the adoption of the protocol put forward by Calpine Canada and providing for the direct supervision of the negotiations between Calpine Canada and the trustees by a court-appointed monitor.

From this brief description of the complexities inherent in attempting to serve both the interests of Calpine Canada and the Fund, it seems evident that fulfilling a fiduciary duty or duty of care to either entity in distressed circumstances would have necessarily precluded the ability to fulfill those duties to the other. It is an open question as to whether it was possible to fulfill a fiduciary duty and duty of care to both entities in non-distressed circumstances given the pervasive aspects of the administration and management agreements. It is interesting that the resignation of the related trustees occurred only two weeks prior to the commencement of insolvency proceedings for Calpine Canada.

2. — Exercising Business Judgment Without Oppression

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As indicated in the *Wise* decision, directors and officers must exercise business judgment in a manner that does not amount to oppressive conduct. We do not propose to set out all of the aspects of exercising business judgment without oppression; that effort has largely been canvassed elsewhere.[FN24] We do, however, want to illustrate how the structure and effect of transactions may be evaluated "after the fact" in a distressed context when assessing allegations of oppressive conduct.

Within less than five months of its acquisition in 2001, Dylex Inc. (Dylex) was put into bankruptcy. In the aftermath, Dylex's trustee in bankruptcy initiated claims against its former directors and officers in office during the acquisition transaction alleging breach of fiduciary duty to Dylex's creditors (the case was launched prior to the *Wise* decision being rendered by the Supreme Court of Canada) and oppression in connection with their handling of the divestiture transaction.[FN25] In response, Dylex's former directors brought motions to strike the claim as disclosing no reasonable cause of action and for a determination on points of law regarding the extent of their fiduciary duty, as well as the standing of the Trustee to bring the breach of fiduciary duty and the oppression remedy claims.

It was alleged by the Trustee that: (a) the transaction was structured to circumvent certain statutory financial assistance prohibitions; (b) the share acquisition was largely funded out of Dylex's own cash and inventory liquidation proceeds; (c) fresh inventory had been acquired from trade creditors for delivery to a liquidator for sale at an amount below cost; and (d) the acquirer had been given control over Dylex and its trade accounts prior to closing, and in doing so the acquirer had been permitted to build cash for the acquisition through the sale of inventory without paying the trade creditors during the interim management period. It was also alleged that the directors participated in structuring a transaction that rendered the corporation insolvent because the acquirer converted corporate funds for its own use in acquiring the shares and misapplied the proceeds of sale of inventory. It was further alleged that the directors should have enquired into the moral character of the acquirer as well as the legitimacy of the purchaser's financing arrangements prior to agreeing to the divestiture transaction.

Ultimately, the Trustee's claims against the directors (and the additional related third party claims filed against counsel) resulted in what has been said to be a multimillion dollar settlement, and no rulings on liability were made by a court. However, allegations made in the *Dylex* case serve to illustrate the importance of ensuring that business decisions are taken by directors in light of all known circumstances and that they consider the likely effects of their decision on a broad category of stakeholders beyond the corporation.

III. — Minimizing Potential Governance Failure

So how might senior management and directors best minimize the potential for governance failure and liability in distressed circumstances, particularly when senior management and directors may change during the restructuring process? A comprehensive review of risk management practices for the effective governance of distressed enterprises is beyond the scope of this article.[FN26] However, we offer the following observations in conjunction with selected "best" practices that might be pursued in order to minimize risk and the potential for governance failure in distressed circumstances.

1. — Reliance on Process and Documentation

We have noted a greater awareness of both senior management and directors of the importance of process and documentation in the exercise of business judgment as a means of both fulfilling duties to the corporation and avoiding acting in an oppressive manner. This awareness appears to have increased as courts and securities regulators shifted their focus onto the decision-making process, documentation underpinning corporate action and

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disclosure for public companies. In distressed circumstances, where it is likely that not all material stakeholders will be equally affected by or agree with directors' decisions, an approach to governance that enhances process and documentation is compelling. It should also assist in meeting the objectives of: (a) stabilizing the business; (b) providing a "roadmap" for the restructuring; and (c) allowing directors to be seen to be acting prudently in fulfilling their fiduciary duty and duty of care as well as to have properly exercised their business judgment. For those involved with distressed corporations of more limited resources or shorter timeframes, a more robust approach to process and documentation can be readily adopted with minimal disruption and should provide for better decision-making and better outcomes.[FN27]

(a) — Get the Facts

As illustrated in the *Wise* decision and the *Dylex* settlement, acting on an informed basis is a pre-requisite to fulfilling a director's duty of care to the corporation as well as to the proper exercise of business judgment. We also think it is a prerequisite to fulfilling a director's fiduciary duty. So a primary focus of governance practice in distressed circumstances should be to ensure that the information necessary for informed decision-making is available. This may entail establishing more robust diagnostic and reporting systems, with or without the assistance of external advisors. It may also entail establishing a special committee of directors to wade through the increased information load that could otherwise flow to the full board of directors without refinement.

(b) — Enhance Diagnostic and Reporting Systems

There are disparate limitations within corporate Canada on the resources available to provide timely, complete, and accurate information to decision-makers and stakeholders. This appears to be largely a function of the availability of skilled personnel and adequate infrastructure, both of which can be severely taxed in distressed circumstances.[FN28] Nonetheless, establishing adequate diagnostic and reporting systems in distressed circumstances should be a primary objective of a risk management approach for both management and directors. These systems are fundamental to being able to: (a) obtain accurate and reliable information concerning the company's business and affairs as well as the most likely causes of distress; (b) take interim steps in order to alleviate that distress; (c) communicate effectively and with confidence to principal stakeholders; (d) successfully refinance or restructure the enterprise; and (e) minimize the personal exposure of directors and others throughout the process.

(c) — Use Decision-Making Systems

The same types of limitations inherent in establishing and maintaining diagnostic and reporting systems apply equally in establishing and maintaining appropriate decision-making systems within distressed enterprises. The limits associated with the availability of skilled personnel, the nature and quality of the information available, and the time permitted within which to take decisions in distressed circumstances will undoubtedly affect the quality of the decisions being taken. So too will the process followed to reach decisions.

(d) — Regiment the Process

To address these limitations, in part, the consistent use of a regimented process for decision-making in distressed circumstances, where possible, can be very helpful. This regimented approach should assist in managing the information generated internally and provide for greater opportunities to obtain and understand the views of multiple stakeholders in connection with material decisions to be taken in respect of the corporation's affairs. It should also limit: (a) biases of management and the board; (b) duress under which management and the board operate; and (c) omissions, which may otherwise negatively influence decision-making. Similarly, the utilization

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of a consistent and regimented process for decision-making should assist in avoiding "snap" decisions being taken on material points in the absence of adequate information and permit a clarity of decision taken relatively free from bias, duress, and omission. In some circumstances, streaming the decision-making process through a small, empowered subset of directors (e.g., in a special committee) or a CRO will allow for a similar result and assist in dealing with the "crisis" aspects of decision-making when time is tight.

(e) — Avoid "Snap" Decisions

Directors and senior management should try to avoid making "snap" decisions on material points affecting the enterprise and its stakeholders. Where possible, staging more than one discussion at successive board or committee meetings on those material points should be encouraged (including after short adjournments over a day or so when time is tight) to permit perspective on material points to develop as far as possible. This approach can be furthered by establishing a special committee of the board to provide two separate venues for considering material issues and should permit, where possible: (a) the formation of initial impressions without a conclusion being achieved or implemented until reconvening the board (including in some instances after short adjournments over a day or so); (b) the formation of more complete and accurate information; and (c) the development of additional perspectives on the issues to be resolved, prior to taking a decision and putting in motion irrevocable steps.

(f) — Use a Consistent Approach

Directors and senior management in distressed circumstances should also try to be consistent in their approach to decision-making. When dealing with material points they should evaluate the likely effect of the actions to be taken, with the benefit of advice: (a) on fulfilling the corporation's objects (essentially determining whether it fits with the strategic objectives of the corporation and whether it will result in a "better" corporation); (b) on the corporation's material stakeholders (essentially whether it "unfairly" prejudices, disregards, or oppresses those stakeholders); and (c) whether it unfairly favours any particular single stakeholder. We also think it appropriate that directors and senior management in distressed circumstances consider the effects of doing nothing on each of those three aspects.

(g) — Keep Consistent Records

The extent to which the deliberations of directors and the advice they have received in conjunction with decision-making should be recorded, particularly with respect to material points at critical stages in corporate life, is a matter of debate.[FN29] Views on the topic typically relate to concerns regarding: (a) the risks associated with each of: (i) the accuracy and completeness of the information and documentation considered; (ii) the advice received; and (iii) the extent of deliberations, to facilitate directors' decision-making; and (b) potential loss of privilege for matters recorded in minutes. Although there are merits to many views expressed in the debate, the one point on which most sides appear to agree is that regardless of whether a comprehensive or minimalist approach is taken to record-keeping there should be consistency in that approach throughout corporate life.

We note that the practices of senior management and directors of distressed Canadian enterprises regarding record-keeping vary greatly whether as a result of the resources available to them, a conscious choice, or neglect. We also note that one of the most helpful aspects of adopting a formal policy on record-keeping during distressed circumstances is that typically, if pursued consistently, it assists in: (a) bringing an enhanced clarity and efficiency to decision-making; (b) limiting the biases and duress under which decisions are taken; and (c) minimizing the potential liability associated with decision-making. We also note that it is preferable not to have a

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number of "variations on the theme" in an approach to record-keeping that provide for fodder and litigation targets in any ensuing challenge of the process and the decisions taken.

(h) — Declare Conflicts and Abstain

Although it should probably occur without having to be said, directors must be free from conflict in acting prudently and on an informed basis in connection with any matter. In the face of a perceived or actual conflict, directors should immediately declare that conflict or potential conflict openly, abstain from voting on matters within the scope of that conflict or potential conflict, and have both the declaration and abstention noted in the minutes of any meeting held on the matter, in accordance with both the strictures and protections contemplated by corporate statutes.[FN30]

2. — Reliance on Advisors

As referred to in the *Wise* decision, both the CBCA and many provincial corporate statutes provide "due diligence" defences to directors who exercise business judgment and fulfill their duty of care and their fiduciary duty to the corporation in reliance upon the advice of others.[FN31] As a result, we are seeing a greater demand from directors of large and small enterprises for written reports from senior management as well as written reports and advice from independent external advisors to assist directors in their decision-making. The terms of engagement of such external advisors and any contractual limitations therein are as yet untested waters that flow beneath this practice.

(a) — Report Content

Based on observations made in the *Wise* decision, we believe that these reports are best framed if they stipulate the known material circumstances facing the corporation and in most instances analyze broadly the effects that various decisions taken by directors may have on the corporation and the material stakeholders in the enterprise, prior to making a recommendation. The range of material stakeholders germane to any particular enterprise was broadly canvassed in the *Wise* decision and will undoubtedly include employees, suppliers, customers, creditors and others and may extend to include non-entities such as "the environment".[FN32]

(b) — Specified Advisors Only

Many corporate statutes prescribe specific categories and attributes of the advisors on which directors may rely in order to feed due diligence defences.[FN33] We note in that regard the widely-adopted and often very useful practice of taking advice from "investment banks" and other "financial advisors" does not appear, in and of itself, to conform to the list of professionals on which directors may rely for the purposes of feeding their statutory due diligence defences. We believe it is appropriate for management and directors to obtain and insist upon receiving advice that will reliably feed statutory due diligence defences. We anticipate participants in the advisory market will make the necessary adjustments to permit those providing advice to do so on the basis that they can assist in fulfilling that objective.

3. — Enterprise-Wide Decision-Making

The Supreme Court of Canada's observations in the *Wise* decision concerning the manner in which directors should fulfill their duties to the corporation and examine the likely effects of their decisions on a number of stakeholder groups has significant implications for decision-making on material matters within corporate groups.

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This element of the *Wise* decision casts light on an emerging area of concern and potential liability: the manner in which directors serving on multiple corporate boards within a corporate group should fulfill their duties when there may be conflicting inter-group objectives or when decisions and actions are likely to have disparate effects on different corporations within a corporate group and their respective stakeholders. It is a part of governance that can become particularly significant in the context of distressed enterprises.

As mentioned earlier, in the Calpine proceedings this potential conflict was dealt with through: (a) recognition and disclosure of the potential conflict; (b) allocation of responsibility for decision-making through the adoption of comprehensive administration and management agreements; and (c) the resignation of conflicted trustees/ directors in advance of insolvency proceedings. Whether that approach was sufficient remains to be seen.

We observe that it appears to have been "market practice" for many corporate groups to have "mirror boards". In the income trust sector, for example, the trustees of the income trust would also serve as the directors or majority directors of the operating entities in which trusts invest. There are now a variety of practices in this regard, but the approach that we are seeing most often recommended in the income trust sector involves the adoption of a majority of independent directors at the operating level in order to avoid the type of conflict inherent in "mirror boards". When the conflict issue surfaced in the Calpine proceedings, a proactive step was taken through the resignation of the conflicted trustees to attempt to manage the conflict and enhance independence. Whether that step was enough in light of the tightly structured administration and management agreements in place is another matter.

In the *Wise* case involving two private companies, only the wholly owned subsidiary had an independent director on its board. Advice and reports concerning the proposed joint inventory procurement policy were obtained from management for both companies. The program was discussed at a meeting of the subsidiary's audit committee that included the independent director. Although there appears not to have been an independent evaluation of the procurement program by directors owing duties only to one of the two corporations, the fact that the matter had been examined by management and was the subject of a report presented to the subsidiary's audit committee (and its independent director) seems to have provided the Supreme Court of Canada with some comfort that an appropriate decision-making process had been followed within the enterprise as a whole.

By contrast, and although the matter is ongoing and not completely resolved, in the Hollinger proceedings [FN34] a loan transaction to a controlling, privately held parent corporation was authorized by the COO of a public company who was also a director of the controlling parent. No related party transaction protocol appears to have been established or followed in respect of the loan transaction, and no independent directors of the public subsidiary appear to have been consulted. The transaction apparently surfaced some two months after it had been effected; and when the full board of the public subsidiary met to consider the loan transaction, the nominee directors of the controlling shareholder apparently did not declare a potential conflict or abstain from dealing with the matter during meetings of the board of the public company.

We are doubtful that this is an appropriate approach to be adopted in effectively governing any enterprise. Regardless, it illustrates some of the difficulties inherent in enterprise-wide decision-making for distressed businesses where there may be numerous "cross appointments" amongst directors and officers of related entities.

4. — Minimizing Procedural Drag

Given the sensitivities associated with enterprise-wide decision-making in corporate groups, and the desirability of minimizing the potential for claims to be made against directors occasioned by enterprise-wide appointments,

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we think that there are a few practices that could readily be adopted which should serve to both minimize risk and the procedural "drag" associated with holding, administering, and minuting separate meetings for each of the boards within a corporate group.

(a) — Unconflicted Directors

First and foremost, it is advisable to ensure that there are directors, or at least a director, as part of the complement of each board within a corporate group that do not serve on any other board within the group. These "independent" directors should be informed and capable of taking a decision in the best interests of that corporation where other directors may be well advised to declare a conflict and abstain from voting for fear that their decision may not be viewed as having been made solely in the best interests of that particular corporation.

(b) — Report Content

Secondly, we think that any reports to be prepared for board meetings, whether from management or external advisors, should be framed by: (a) stipulating known material circumstances facing each corporation in the corporate group likely to be affected by the decisions taken in connection with material issues addressed in the report; and (b) analyzing broadly the effects that material decisions taken by directors of each of those corporations may have on the material stakeholders in each of the corporations, prior to making a recommendation. Although it may not always be possible or advisable to structure reports on that basis (for example, where the nature of the issue would suggest a need for independent advice at any particular corporation within a corporate group), failing to do so, where possible, may introduce an unnecessary liability profile.

(c) — Consecutive Meetings

Thirdly, where possible, meetings of directors of corporations inside corporate groups that are likely to be affected by decisions taken on an issue should be held one immediately after the other. Where there are cross appointments, directors may convene *seriatim* without the loss of time occasioned by travel and other commitments.

(d) — Consent Agendas

Fourthly, so-called "consent agendas" should be used to clear the agenda of routine matters and allow for a more meaningful discussion of the essence of the material issues and decisions to occur at each affected corporation's directors' meeting.

(e) — Separate Agendas and Minutes

Although we think it is important to maintain separate agendas and minutes for each of the necessary meetings of directors of corporations within a corporate group, in circumstances where there are cross appointments, each of those agendas and minutes may be circulated as one package at the same time in advance of the meetings.

5. — Selected Private and Public Company Differences

We are doubtful that there is a single "one size fits all" approach to governance that can adequately address or take into account the different circumstances and obligations facing distressed private and public companies in Canada. Indeed, given the disparate sizes of many of Canada's private and public companies, we are also doubtful a "one size fits all" approach to governance is apt throughout either private or public company realms.[FN35]

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Nonetheless, there are certain key differences between private and public corporations that we observe typically lead to very different outcomes in governance processes and results.

(a) — Disclosure Obligations

The disclosure obligations and their associated risks inherent in capital market participation in Canada (or in foreign markets for that matter) are extensive and beyond the scope of this article. However, there is no denying their burden or the consequences of failing to meet them. Accordingly, most public companies have established, or are in the process of establishing, advanced information and reporting systems as part of their internal control function.

The Canadian Securities Administrators' Multilateral Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, requires Chief Executive Officers and Chief Financial Officers of public companies to include (for the first time) in their annual certificates for financial year-ends after March 31, 2006, statements about the design of internal controls over financial reporting and related public disclosures. This is in addition to existing certifications that address disclosure controls and procedures. This certificate is a "core document" that will attract liability for directors and officers under Ontario's regime for civil liability in connection with public market disclosure. Review and approval of such certificates by audit committees and boards is recommended by the Canadian Institute of Chartered Accountants as a best practice — yet another persuasive reason for audit committees and boards of directors to ensure they are informed about internal controls over financial reporting and are engaged in the certification and disclosure process.

None of those public market disclosure obligations apply in the context of private corporations (unless a subsidiary is consolidated with its public company parent corporation or they have accessed public debt markets). As a result, many private companies have less advanced information and reporting systems than public companies.

(b) — Extent of Resources

As stated above, the resources available to public companies typically exceed those which are available to private corporations. Quarterly and annual reporting deadlines for public companies are getting shorter (in the interests of timely reporting) while the issues and rules relating to reporting are growing more complex. As a result, the numbers of skilled employees, information technology assets, and business process disciplines typically employed by public companies have increased generally to permit more timely, complete, and accurate information gathering and disclosure to stakeholders. Of course there are exceptions and anomalies, but generally the nature and quality of the information available in public companies reflects superior resources.

(c) — Shareholder Interests

The manner in which shareholder interests may exert "control" or "influence" in the context of private and public companies also differs. In private company settings it is not unusual to have effective shareholder control in the boardroom through much more immediate "hiring and firing" powers. In addition, it is not unusual for unanimous shareholder agreements or declarations to be entered into that may restrict the ability of directors to do certain things in managing the corporation's affairs.

By contrast, the ability of controlling shareholders to assume direct control of decision-making in the boardroom is much more circumscribed in public company circumstances. Indeed, given Canada's public markets regulatory framework, the trend towards independent director appointments, minority voting requirements and the like,

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public companies with controlling shareholders typically function in a manner consistent with good governance practices, although that is not always the case. In distressed circumstances, it is not unusual to see the appointment of special committees of public company boards to assist in managing potential conflicts through exclusion of controlling shareholder nominee directors.[FN36] To be effective, these special committees should be comprised of a majority of independent directors.

(d) — Foreign Parents

Given the relatively large level of foreign investment in Canada, particularly in some of our most significant enterprises, it is not unusual for there to be a foreign parent corporation seeking to exercise control over the affairs of a Canadian subsidiary, usually a private corporation but occasionally with minority public shareholders. In doing so, numerous cultural and legal differences can arise, including the expectation of the manner in which local management and directors will respond to direction by the foreign parent. It is all the more pronounced in distressed circumstances where senior management and the board of the Canadian subsidiary may well face legal duties and risks that may compel them to act in a somewhat different manner from the expressed instructions of a foreign shareholder.

6. — Managing Personal Liabilities

As stated earlier, the governance of a Canadian enterprise in financial distress is not for the faint-hearted.[FN37] Fulfilling duties to the corporation with due regard for the interests of affected stakeholders while seeking to achieve a successful outcome can be invigorating and rewarding, but frequently is an overwhelming challenge for those not skilled in the area. It can also be personally perilous. In order to encourage the continued service of skilled people with adequate knowledge about the operations and affairs of the distressed enterprise and to obtain the support of other skilled persons loyal to the cause, steps need to be taken and protections granted in order to minimize the personal exposure of directors and others involved in the effort, while at the same time maintaining an appropriate measure of accountability.

Those steps will typically include structuring operational protections within the corporation's control (so-called "operational protections"); obtaining protections from third parties, such as insurers, sponsors, and others (so-called "third party protections"); and protections inherent in court-based insolvency proceedings and the resulting plan, if any (so-called "court protections").

(a) — Operational Protections

The full scope of those operational measures which may be taken to assist in reducing the personal exposure of directors and others in distressed circumstances is beyond the scope of this article, but we offer the following observations on selected best practices.

(i) — Retain Skilled Advisors

At the risk of appearing self-interested in this respect, we cannot stress enough the importance of retaining skilled financial and legal advisors as early as possible in distressed circumstances so that a period of diagnosis and analysis can be undertaken aimed at determining: (a) the true causes of distress; (b) a number of potential outcomes; and (c) the means needed to achieve or avoid those outcomes. Professional diagnosis and analysis will typically reveal many aspects of the distress that were not fully understood previously or that did not strike management or the board as being significant in their attempts to deal with the distress. Professional diagnosis

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and analysis will also typically result in an enhanced ability to achieve a successful outcome in resolving the distress and minimize personal exposure for directors and others in less desirable outcomes.

(ii) — Establish Adequate Diagnostic and Reporting Systems

Establishing adequate diagnostic and reporting systems is fundamental to being able to: (a) provide timely and reliable information concerning the enterprise's business and affairs to stakeholders; (b) successfully refinance or restructure; and (c) minimize personal exposure to directors and officers. Cutting corners and restricting or reducing the necessary human or capital resources to support adequate information systems is not a preferred approach in distressed circumstances because adequate and reliable information systems will be needed. Although it is possible to augment the enterprise's internal resources with those of external suppliers to develop financial and other information throughout the distressed period, it is expensive to do so and there is a significant "ramping-up" that needs to be done by external providers before they are able to provide the same level of information as trained and capable internal personnel.

(iii) — Assess D&O Liabilities

In our experience, most directors and senior management do not fully appreciate the nature and extent of the liabilities (statutory and otherwise) they may face in distressed situations. For example, accruing and unpaid operating obligations (such as for vacation pay), statutory liabilities (such as for environmental damage), and statutory offence provisions (such as for unfunded pension contributions) can all represent pitfalls that directors have not considered or quantified as potential personal liabilities. Similarly, "up stream" liabilities may pose a personal risk for directors and senior management and can vary depending on the jurisdiction of origin and the resolve of foreign governments, creditors, and others to pursue the "directing mind and management" of defaulting subsidiaries. We advise senior management and boards in distressed circumstances to conduct an internal assessment to understand the full scope of their current and possible liabilities as part of their informed decision-making process.

Conducting an internal assessment of the risk factors associated with personal liabilities should identify the extent of: (a) the potential personal liabilities facing directors and officers for conduct to that point[FN38] and for statutorily required payments that may go unpaid; (b) any existing insurance coverage and any additional coverage required; and (c) any additional protections needed to induce those directors and officers to remain in office during the distressed phase. The assessment will also permit senior management and the board to understand the extent to which the assets of the enterprise may be available to "feed" applicable statutory due diligence defences in respect of obligations for which directors and officers may be statutorily liable.

(iv) — Feed Due Diligence Defences

In many instances where statutes provide for director or officer liability in the event amounts due by corporations go unpaid, those statutes also provide for defences in the event directors and officers exercise the degree of diligence considered to be appropriate by the statutory standard. Administrative practice may also require specific steps to be taken to feed the due diligence defence. For example, the Canada Revenue Agency has stated that a director must attempt to take positive action to exercise due diligence in respect of liabilities under the *Income Tax Act*[FN39] and the *Excise Tax Act*,[FN40] respectively, by, *inter alia*, establishing an account for withholdings from employees as well as for remittances of net GST amounts to avoid liability if such amounts go unpaid.

(v) — Pre-Fund Segregated Accounts

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To the extent that available liquidity and lenders will permit, pre-funding segregated bank accounts in respect of certain statutory obligations will assist in meeting the standards of due diligence contemplated by, for example, the *Income Tax Act*.[FN41] These segregated accounts should be established in compliance with the covenant provisions of any credit facilities, debt instruments, and security agreements to which the corporation is subject. The adoption of more rigorous cash management and collection policies may provide a somewhat better liquidity platform from which to be able to fund statutorily required payments; it is also just good business.

(vi) — Require Officer's Certificates

Although it may seem routine to expect delivery of certificated statements of position monthly from senior corporate officers, it does not always happen. In distressed circumstances, it is imperative that such certificates are delivered and stipulate, at a minimum, that all amounts to be paid or pre-funded in respect of directors' liabilities were paid or pre-funded when due.

(vii) — Audit Committee Confirmation

In those circumstances where a robust governance structure has resulted in the composition of an audit committee, it is advisable that the audit committee conduct either a monthly or a quarterly (or more frequently depending upon the state of distress) review of the enterprise's use of cash and payments made in order to feed the due diligence defences on which directors and officers may rely.

(b) — Third Party Protections

There are essentially three potential sources of funding that directors and others may look to beyond the corporations they serve and their personal assets in order to fund liabilities in the aftermath of a failed restructuring attempt. They are insurance coverage, indemnities, and trusts. Each of them needs to be looked at in its own right as enforceability of rights to payment and qualifications for coverage will vary among the three sources.

(i) — Insurance Coverage

Directors' and officers' insurance coverage should not be taken for granted not only with respect to its availability, but also with respect to the scope of coverage in place. All too often we see distressed corporations facing looming expiry dates on directors' and officers' insurance coverage. Often the situation is hampered by an inability to provide the requisite level of information to insurers to permit them to extend existing coverage, underwrite new coverage, or provide appropriate "run-off" coverage.

Early in any distressed circumstance, directors and officers should initiate a review of their existing insurance coverage. That review should include not only the scope of the insurance coverage and the policy limits, but also the extent to which there are "exclusionary clauses" and "same entity" clauses which may have the effect of reducing available coverage for individual directors. Existing policies should be examined also to see whether they entitle the policyholder to buy "run-off" coverage so as to extend the reporting period during which claims may be made in respect of alleged liabilities that arose during the policy period. Consideration should be given also to developing a "laundry list" of claims and potential claims that may need to be made in respect of expiring policies or during the run-off period, as part of the assessment of potential directors' and officers' liabilities referred to above.

We see a developing trend towards directors seeking individual coverage, or coverage for directors as a group,

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separate and apart from the coverage that may be available to the corporations they serve. This appears to have developed largely as a result of two factors: (i) exhaustion of policy limits through the making of numerous claims against policies in distress circumstances, where the aggregate of the claims made exhausted coverage limits before directors made claims; and (ii) the presence of exclusionary clauses (which typically purport to prevent or deny coverage in circumstances where an insured has sued another insured), where corporations or related parties covered by the policies brought actions against the directors and the insurer denied coverage. [FN42]

More recently, we have seen insurance coverage provide specific exclusions for securities-related actions that might be brought against directors by a significant shareholder (generally, 10% to 25% and greater holdings). This carve-out appears to have its genesis in the United States where directors' duties may extend to shareholders in many circumstances. As it is quite conceivable that directors of a Canadian company could, and may be required to, act in the interests of the corporation where those interests are contrary to the interests of a significant shareholder, insurance coverage needs to be reviewed carefully.

(ii) — Indemnities

There are many circumstances where individuals serve on boards of directors or as corporate officers only on the basis of an indemnity that has been obtained from a credit-worthy third party. An indemnity can take many forms, but to meet the objective of inducing qualified people to serve as directors or officers it will typically provide for full indemnification in respect of any liability occasioned in serving as a director or officer, subject to exclusions for gross negligence, wilful misconduct, and illegal acts. Where possible, the indemnity should extend to indemnify the directors/officers for any costs and expenses to which the director or officer may be put in defending themselves from a potential finding of liability as well as provide for funding such defence costs concurrently as they are incurred.

(iii) — Trusts

During the past 15 years, a number of CCAA cases have seen disclosure and court approval of trusts that had been established by debtor corporations for the benefit of their directors and officers in order to induce them to continue to serve during the distress phase.[FN43] As has been suggested elsewhere, there have been few challenges to the creation of trusts to protect directors and officers, likely because most participants in CCAA proceedings have recognized the advantages of ensuring the continued participation and cooperation of key management and directors in office while developing and implementing a successful plan.[FN44] When challenged, it is not unusual for creditors to allege that, in authorizing the establishment of such trusts, directors acted in conflicted self-interest: taking monies that would otherwise have been available to pay creditors and using it to protect the directors from liabilities that might otherwise be unsecured obligations of the corporation or theirs alone to bear.

Accordingly, directors' and officers' trusts are best established early in distressed circumstances: (a) in compliance with covenant patterns contained in credit agreements, debt instruments, and security documents granted by the corporation; (b) in the face of a genuine recommendation from independent counsel to directors and officers that they resign if such a trust is not established, so as to assist in defending the establishment of the trust in the face of creditor opposition; and (c) preferably, with the concurrence of the debtor corporation's principal creditors. Of course, finding a qualified trustee and settling a discretionary trust deed is not easy; no trustee wants to assume any liability or bear uncovered expense in connection with funds placed in trust.

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(c) — Court Protections

(i) — Stays of Proceedings

Both the CCAA and the BIA provide that in the event insolvency proceedings are commenced by a debtor corporation, a stay of proceedings may be imposed for the duration of the proceedings in respect of actions against directors. In the case of proceedings under the BIA, the stay automatically occurs in respect of claims that arose before the commencement of proceedings, where directors are liable in their capacity as such for the payment of obligations by the corporation. Similar provisions are contained in the CCAA and, although the application of the stay is discretionary, most courts supervising CCAA proceedings will typically grant such a stay. In each case, the stay does not operate to prevent an action against a director in respect of a guarantee or an action seeking injunctive relief against a director in relation to the corporation.[FN45]

(ii) — Court-Ordered Charges

Courts supervising CCAA proceedings typically grant a form of charge by court order over all of the assets of the debtor corporation to secure indemnities provided to its directors and others in order to induce them to continue to serve.[FN46] The scope of that charge is typically a matter of negotiation between the debtor and its principal creditors — but that has not always been the case — prior to the filing of court proceedings.[FN47] So too, the quantum of any directors' charge (whether it is an unlimited amount or whether it is limited to specific dollars) and the priority of such charges over existing secured claims is typically a matter of negotiation.[FN48]

The availability of court-ordered charges to support directors' indemnities should not be taken for granted. In the Canada 3000 CCAA proceedings[FN49], the directors and officers were granted a charge in the initial order. However, shortly thereafter the airline ceased operations notwithstanding language contained in the initial order requiring Canada 3000 to carry on business. In subsequent hearings, the directors and officers charge was retracted and an order made removing the charge *nunc pro tunc*.

In the Air Canada CCAA proceedings,[FN50] an initial order was obtained that provided for a court-ordered charge to support an indemnity provided by Air Canada to its directors for liability in excess of existing insurance amounts. In the face of a further hearing on the matter occasioned by opposition from certain of Air Canada's creditors, it was determined that where a directors' charge is granted to secure indemnities in respect of excess liability, the directors should still be exposed to some level of reasonable liability risk as an inducement for directors and officers to formulate a restructuring plan that would eliminate that liability. In those circumstances, the court decided that individual directors should contribute an amount up to 5% of the liability that may ultimately be found to apply. It perhaps goes without saying that in large cases 5% could easily prove ruinous.

In the Afton Food CCAA proceedings,[FN51] an initial order included provisions indemnifying directors and secured that indemnity by a third ranking charge on assets in an aggregate amount of $1 million (D&O Charge). The restructuring attempt failed, and approximately one year later a court-ordered receiver was appointed with its own series of charges under the receivership order, which also confirmed the D&O Charge. The receiver brought a motion to determine whether the D&O Charge extended to: (a) directors' liabilities existing prior to the commencement of the CCAA proceedings; and (b) legal fees paid or payable to counsel for the directors.

The initial CCAA order contained both: (a) general indemnity provisions in respect of liabilities covering claims arising from directors' activities after the commencement of the CCAA proceedings; and (b) an additional in-

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demnity provision in respect of claims asserted after the date of the initial order but in respect of pre- and post-filing obligations. Ultimately, the court determined that the language of the D&O Charge covered both pre- and post-filing liabilities, and extended to legal fees and disbursements paid by those directors to more than one set of counsel and above amounts paid by Afton Food. The case illustrates the potential conflict between the scope and priority of court-ordered charges in CCAA cases and other charges created subsequently in the event a re-structuring attempt fails.

Where possible, directors should seek indemnification for and a charge in respect of both statutory and other liabilities, whether those liabilities were occasioned by pre- or post-filing conduct. In addition, care should be taken in prescribing the scope of the court-ordered charge to be granted in respect of those liabilities so as to ensure that it does not limit: (a) directors' or officers' entitlements to something less than 100% of the liabilities; or (b) the ability to seek indemnification for the fees and other expenses that may be paid in defending against those types of liabilities.

(iii) — Plan Protections

There are two primary mechanisms typically included within plans of compromise or arrangement which may be approved by creditors and sanctioned by supervising courts that offer protections to directors and officers: (i) releases of claims; and (ii) payment obligations in implementing the proposal. The scope of the releases capable of being included in confirmed plans of arrangement and compromise is limited by statute.[FN52] However, we think it advisable that releases in confirmed plans be full and worded broadly so as to extend to all pre-and post-filing liabilities, subject to the provisions in the CCAA and the BIA limiting releases. It has been argued by some that the effect of such a release would be to load potentially significant liabilities onto debtor corporations post confirmation of a CCAA plan. We think exactly that type of a prospect is what is most likely to restrain the creditors of a debtor corporation from launching lawsuits against directors for non-released claims, as the effect of doing so could be to imperil the corporation in which those creditors have agreed to a compromised interest.

Both the CCAA and the BIA provide for specific payments that must be made in conjunction with the approval and implementation of a plan of arrangement or compromise.[FN53] Funding those payments is an integral component of effecting a successful restructuring and ensuring there will be no claims made against directors for those amounts.

IV. — Managing Internal Governance Changes

Typically, a "crisis of confidence" develops as corporations become distressed. Elements of trust necessary to the healthy internal and external functioning of a business that existed in good times can disappear very quickly. As the distress becomes more pronounced and trust erodes, there is a tendency of directors and senior management to form and rely upon alliances within and between their respective ranks that can lead to adverse results. Standard operating procedures and assumptions can be easily disregarded or overlooked, and it is a time when important governance aspects can easily break down — if they exist at all.

When a crisis materializes the "tone from the top" becomes even more important as employees, creditors, suppliers, customers, and others look for leadership within the distressed business. In some distressed circumstances, the board or senior management (or both) that endorsed a failed business plan may be too wedded to a course of action or discredited by acts, omissions, or events to be able to: (a) objectively assess the results that have moved a company into distress; (b) see the problems and identify the measures necessary to reverse the decline; and (c) "do the right thing" so as to be able to make necessary changes. They may also be paralyzed by the

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spectre of potentially ruinous liabilities, uncertain of what to do to address the situation, and considering resignation "while the getting's good".

Internal governance changes happen in distressed circumstances, whether as a result of internal or external forces, and they typically result in one or more of: (a) reconfiguration of governance processes; (b) augmentation or replacement of senior management; or (c) resignation or removal and replacement of directors. Of course, there are varying stages of distress and varying degrees of change required in varying distressed circumstances. Nonetheless, we offer the following observations in conjunction with selected best practices that might be pursued to manage the transitions in governance that most frequently arise in distressed circumstances.

1. — Reconfiguring Governance Processes

We do not intend to reiterate here all of those governance aspects that might be usefully reconfigured in distressed circumstances and are discussed above. However, we offer the following observations on three changes to governance that are most likely to assist in successfully addressing distressed circumstances, if implemented early on.

(a) — Place the Audit Committee on Alert

The warning signs that a company is heading toward distress rather than a temporary downturn are common, and when they appear it is typically time for directors to take proactive steps beyond what senior management might be recommending. The most obvious financial warning signs include:

(a) continued losses;

(b) a deteriorating accounts payable profile;

(c) the loss or tightening of supplier credit;

(d) sustainable cash flow that is less than debt service costs;

(e) lending covenant breaches;

(f) substantial reductions in discretionary expenditures as free cash flow declines;

(g) a decreasing order backlog;

(h) significant efforts to raise new financing; and

(i) unusual changes to accounting standards applied to the preparation of financial statements.

In many cases, the warning signs come from beyond the company's financial profile but can be just as indicative of a looming crisis. These include:

(a) dissention among and high turnover of key management;

(b) low employee moral, poor labour relations, and position vacancies;

(c) a focus on short-term "band-aid" solutions;

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(d) frequent changes in the company's strategy or business plan; and

(e) a drive for growth at all costs, often to "mask" problems.

At any time when these factors appear, audit committees should be increasing their vigilance and activity levels, looking at the changes in these factors on a comparative basis, and requiring more detailed explanations from senior management concerning the reasons why these factors have appeared. These warning signs are equally applicable to smaller corporations without formal audit committees and should be investigated by a special committee of directors or the full board, as appropriate.

(b) — Establish a Special Committee

In the public company realm, the establishment of special committees of directors has introduced a powerful catalyst for effective governance change in distressed circumstances, with some interesting results. Smaller groups of directors free from conflict and with the level of independence, expertise, and availability necessary are now often the first and primary forum for examining the most pressing issues facing distressed corporations. Although the formal roles and functions of special committees in distressed circumstances vary, essentially, they allow for a highly focused treatment of the issues to be dealt with and filter out extraneous factors that would otherwise clutter up the full board's agenda. Establishing a special committee with a broad enough mandate, scope of authority, and professional support to address the issues facing a distressed corporation can also be an effective means of demonstrating leadership to the corporation and all of its stakeholders when they need it most.[FN54] Special committees are equally compelling in private company circumstances.

In distressed circumstances, special committees are typically best suited to: (a) carrying out focused investigations, whether into (i) management's conduct, (ii) the reasons for failures in internal controls, or (iii) the principal issues causing the corporation's distress;[FN55] (b) relieving the full board from the level of detailed examination required at first instance to fully understand the matters assigned to the special committee;[FN56] and (c) excluding conflicted directors (including executive directors) from formally participating in the deliberations critical to the corporation's affairs.[FN57] Special committees also typically require the support of skilled experts and professionals to effectively complete their mandates.

(c) — Retain Skilled Independent Advisors and Use Them

As mentioned above, at the risk of appearing self-interested in this respect, we cannot stress enough the importance of retaining skilled financial and legal advisors as early as possible in distressed circumstances so that a period of diagnosis and analysis can be undertaken aimed at determining: (a) the true causes of distress; (b) a number of potential outcomes; and (c) the means needed to achieve or avoid those outcomes. Professional diagnosis and analysis will typically reveal many aspects of the distress that were not fully understood previously or that did not strike senior management or the board as being significant in their attempts to deal with the distress. Professional diagnosis and analysis will also typically result in an enhanced ability to achieve a successful outcome in resolving the distress and minimize personal exposure for directors and others in less desirable outcomes.

Retaining independent advisors is advisable for most special committee mandates in distressed circumstances; and it is advisable for any board facing distressed circumstances to retain advisors in respect of their own liabilities, separate from those who have advised the corporation through senior management to date. That is not to say incumbent advisors will be an inappropriate choice in some circumstances. However, if the financial advis-

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ory firm investigating a financial statement misstatement on behalf of a special committee, for example, is the audit firm that signed off on the misstatement, special oversight arrangements should be instituted for independent financial advisors to supervise the investigation.[FN58] Independent advisors should report directly to the special committee or the board, as the case may be, and not to senior management, although in many circumstances it is a best practice for them to work closely together.

2. — Augmenting or Replacing Senior Management

It is often said the team that got a company into distress is not likely to get it out. In some cases the incumbent team can work out the distress, but generally incumbent teams do not as a result of: (a) the need for differing skill sets to successfully address the distress; (b) lack of resources to weather the distress; or (c) resignation or removal occasioned by a loss of confidence of key stakeholders or a change of control. Whether it is best to augment existing management or engage new senior management to address the distress depends on many factors including: (a) the degree of distress; (b) the circumstances and management's role in connection with the distress; and (c) the time available. Clearly, when a lack of credibility of senior management exists in distressed circumstances, it will undermine the confidence of the board and all of the corporation's stakeholders when they need it most. Uncertainty and mistrust do not play well and are as corrosive to a company as rust is to metal.

(a) — Augmenting Management

Many directors and senior managers are unable to see the strategic or systemic faults leading their organizations into distress and tend to deny that their organizations are heading in that direction. All too often, senior management and directors dealing with financial distress believe that their main challenge is to find the cash to meet the organization's "burn rate" and, if they can only take interim steps to bridge to a time when sales increase or new money comes in, all will be fine. We think the passage of time and denial, not a lack of cash, are usually the biggest enemies in the early stages of decline. Any period of denial wastes valuable time to address the underlying reasons for the distress and usually adds to it. In many circumstances, wholesale changes to senior management are neither warranted nor advisable to adequately address the issues causing the distress. Instead, retention of a financial advisor or a CRO to augment existing senior management as a complement to their skill sets may be advisable. In other cases, more drastic steps may be required.

(b) — Replacing Management

In some cases, such as the informal restructuring of Atlas Cold Storage Holdings Inc. (Atlas Cold Storage) where a "whistleblower" letter surfaced serious financial statement misstatements, the need for changes to senior management can be immediate. More often than not, however, even in distressed circumstances changes in senior management need to be made in an orderly manner with all of the circumstances of the situation well considered. For example, in the AT&T Canada proceedings, continuing operational challenges, delayed organizational changes, and concerns regarding a member of senior management were addressed in the middle of the court-based restructuring by: (a) solidifying and enhancing the positions of the CEO and CFO; and (b) engaging in advanced discussions with a potential replacement President and COO, prior to simultaneously announcing the incumbent's departure and the identity of his replacement. This approach alleviated some of the risk associated with a termination of a key member of senior management in the middle of insolvency proceedings.

Not every situation where a senior management change is required in distressed circumstances resolves itself so readily. In those circumstances, retaining a CRO may well be the preferred approach either because time does not permit a broad search or because attractive permanent candidates will not signon until after the distress has

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been dealt with.

(c) — Hiring A Skilled CRO

Hiring a skilled CRO typically has a very positive effect immediately on an enterprise. Regardless of whether the CRO serves in an augmentative or replacement capacity, the hiring sends a very visible signal that: (a) leadership with the skill sets necessary to address the distress is on board; (b) the company and all its stakeholders can have confidence that the distress will be addressed; and (c) cautious optimism that things will change for the better is well placed. We observe, however, that more often than not directors fail to act and do not appoint an effective CRO until senior management has exhausted much of the time that could have been better used by addressing needed changes.

CROs typically serve as a "rallying point" and can be effective leaders of change, but each distress situation presents its own challenges and may call for specialized skills. Not all CROs are alike. There are, however, certain characteristics effective CROs share that generally include the following leadership qualities:

(a) People skills: for a CRO to have the ability to lead change and influence others to act or follow, they must have superior "people skills". It is as important for the CRO to get along with people as easily in the boardroom as on a shop floor;

(b) Managerial skills: CROs should have extensive experience running or advising businesses in crisis. Knowing how to meet deadlines in compressed timeframes is critical;

(c) Strategic skills: CROs needs to use and promote strong, flexible strategic thinking for all personnel in the organization to create solutions and avoid mistaking tactics for strategy; and

(d) Job knowledge: CROs should have a full complement of technical skills or be able to supplement their knowledge and experience with the extensive background of highly skilled people in the financial, operational, and technological aspects of the business.

(d) — Differing Nature of Engagements

Not infrequently, a CRO is hired by a distressed corporation as a requirement of continued support by a lender or significant creditor group. In those circumstances, in addition to the other factors of the appointment referred to above, the CRO (and any financial advisor to the company) must work quickly to assess the viability of the business and to determine what can be done to stabilize the situation. In other situations, the CRO can take some time to understand what senior management has been trying to achieve and assess it free from any vested interests.

In light of: (a) directors generally asserting themselves more, particularly in distressed circumstances (a good thing); (b) stakeholders generally becoming more vocal in wanting to have material input in determining the future direction of distressed enterprises; and (c) the spectre of changes being made at both senior management and board levels in any distressed circumstance, the CRO is often faced with a complex array of relationships and governance issues.

(e) — Direct Board Reporting

In order to be able to effect change, it is imperative that the CRO report to the board, or a special committee of

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the board, rather than reporting to senior management who have been part of the corporate decline. Layering senior management between the board and the CRO typically creates unnecessary and undesirable tension in the relationship between CEO and CRO as well as causes delays in meeting the need for change. The CRO also needs the backing of the board to solidify the power base for change. This approach typically sets the stage for re-invigorated management and for the board to: (a) concentrate on a few clear and specific initiatives; (b) clarify the vision and behaviour expectations for the enterprise; and (c) leverage strong leadership skills to remove dysfunction. This approach also typically maximizes opportunities to successfully implement a clear strategy with a focus on: (a) decisiveness; (b) execution; and (c) delivering on commitments.

(f) — Build Bridges to Stakeholders

The CRO appointment will also typically establish a renewed rapport between the board, senior management, and other key stakeholders. That rapport may result from many characteristics of the individual CRO hired: (a) an expanded reach and skill set; (b) the "been there before" experience factor; and (c) the ability to build bridges with stakeholders that senior management previously involved in those relationships were unable to build or maintain. It may also result from the mere fact that someone new without the baggage attendant on strained relationships is viewed as being charged with the responsibility of addressing critical issues.

(g) — Meet Frequently

In our experience, it is imperative to get face-to-face with key stakeholders early and often in distressed circumstances, particularly as key stakeholders positions are likely to change based on secondary market activity where "new" stakeholders buy positions in the debtor's capital structure. Without this type of personal interaction it is very difficult to re-establish the level of trust required to build anew. Appropriate non-disclosure and confidentiality agreements will allow for appropriate levels of disclosure and dialogue (even in public company circumstances) necessary to work through the issues important to key stakeholders. This "open kimono" approach to relationship building can be achieved by a CRO through "flash" reporting, regular confidential briefings and facilitating direct meetings with major stakeholders to confirm their intentions.

(h) — Demonstrate "Success" Factors

Appointing an effective CRO will typically demonstrate the following "success" factors to key stakeholders that will allow them to build confidence in the "new" direction the distressed enterprise has chosen:

(a) top-level commitment;

(b) management stability;

(c) a sense of urgency;

(d) a significant focus on execution;

(e) maintaining a broad multi-stakeholder focus;

(f) avoiding quick fixes no matter how tempting they are;

(g) distinguishing between re-engineering and cost-cutting; and

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(h) finding and protecting bold thinkers.

While there are many positive aspects that can result from the appointment of an effective CRO, the importance of a capable and well-advised board of directors to a successful outcome cannot be overstated in distressed circumstances.

3. — Resignation, Removal or Replacement of Directors

In 1996, one of Canada's leading authorities on governance testified in respect of possible changes to the CBCA, as it then existed, before the Senate Standing Committee on Banking, Trade and Commerce. In advocating for adequate statutory protections for diligent directors, the point was made that directors facing the prospect of corporate insolvency and a potentially ruinous set of personal liabilities for statutory obligations were left with no choice but to "abandon ship" with hopes that the financial tidal wave looming over their heads would abate and provide a smooth run to the beach. So, it was said, any law that compelled diligent directors to resign at the very moment when they are needed most, was dysfunctional in the extreme.[FN59] Although the CBCA was amended in 2001 to allow for due diligence defences for certain liabilities,[FN60] the abuses occasioned by recent and notorious large-scale frauds have dissipated what little public sympathy there might have been for the lot of diligent directors, and it is unlikely that sentiment will change in the near term.

A discussion of the relative merits, or lack thereof, of a legislative policy providing directors with balanced protections from ruinous liabilities is beyond the scope of this article. However, we note that the existence of potentially ruinous liabilities is a significant factor in an individual director's determination of whether to serve, to continue to serve, or to resign as a director in distressed circumstances.

On a completely different tack, in working out distressed circumstances, consideration should be given to whether or on what basis directors in office during the decline of the business should continue to serve. Changes in board composition may be required as an aspect of resolving the distress. There are also circumstances in which there may be a change of control that occurs during the course of working out a corporation's distress that may result in "involuntary" changes in board composition.

(a) — Resignations

In our experience, board members do not easily relinquish their roles. It is generally not in the make-up of those who seek to govern corporate activities to readily remove themselves from the fight to restore a company. However, resignation, removal or replacement of directors is not necessarily a harmful event. In many circumstances, that may be exactly what is required to achieve a restructuring that will preserve the greatest value. The manner in which the resignation, removal or replacement is handled is important. The scope of the change to the board, together with its timing, will have a significant impact on whether the change is viewed as being helpful or harmful to the corporation.

The Atlas Cold Storage restructuring was occasioned by what has been referred to as a "financial statement misstatement", where a misclassification of expense and misrepresentation of activity, among other things, undermined the integrity of publicly disclosed financial statements and shook the confidence of key stakeholders. As a result, a special committee of directors was established to examine both the circumstances giving rise to the misstatement and its extent. Both the CEO and the CFO of the company resigned as officers and directors, a CRO was hired, interim directors appointed, and a search process commenced for both replacement senior management and a reconstituted board of directors of the main operating company and the trustees of the public trust.

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In those circumstances, the resignation of the executive directors had a very salutary effect on the ability of Atlas Cold Storage to address its governance issues. It allowed for a process of: (a) careful examination of internal controls (including an opportunity for middle management to speak frankly about circumvention); (b) an evaluation of the composition of the then current board of directors and trustees; and (c) the commencement of a recruiting process designed to assist in obtaining the best possible directors/trustees going forward.

A far less welcome result occurred in connection with Bracknell Corporation (Bracknell). Until the collapse of the telecom sector in 2001, Bracknell provided a full range of infrastructure services for networks, systems, production facilities, and equipment for companies throughout North America. Bracknell had also made a number of acquisitions to expand its business prior to the telecom sector collapse. At the end of the third quarter in 2001, Bracknell posted a net quarterly loss of approximately US$275 million, largely related to a write down of goodwill as its telecomm and fibre optic investments were worth a fraction of what they had paid for them.

Bracknell lost the support of its senior lenders, and the potential liabilities facing the directors were too daunting for them to bear if they continued in office while Bracknell traded absent the support of its lenders. On the basis of advice, Bracknell's directors and officers resigned *en masse*, leaving Bracknell as a rudderless entity. Bracknell's senior lenders moved quickly thereafter for the appointment of an interim receiver with no operating powers. All of this left stakeholders spinning. The standoff between lenders and Bracknell's board and senior management, as well as the governance vacuum created by the resignations, fuelled a catastrophic business failure resulting in a liquidation process and a loss of hundreds of millions of dollars. Whether the losses could have been reduced if the board had remained in office longer is a matter of debate.

(b) — Removals

Unless voted out of office or disqualified by incapacity, typically the only way directors can be removed from office is by court order. When and on what basis such an order should be made in distressed circumstances has recently been the subject of judicial comment.

In January 2004, Stelco Inc. (Stelco) filed for protection from its creditors citing losses from high labour, energy, and pension costs leading to an inevitable insolvency.[FN61] However, at the time, Stelco had approximately $750 million in retained earnings and rising steel prices helped return the company to profitability during the insolvency proceedings. This led to a significant debate about the treatment that shareholders should receive both during the insolvency proceedings and in any plan that might be proposed therein. A significant group of shareholders approached Stelco and indicated that they wished to nominate two individuals who had been vocal on behalf of shareholder interests to serve as directors to fill vacancies that had occurred by resignation. Stelco's board of directors exercised its corporate power to appoint the two shareholder nominees to fill those vacancies and established a comprehensive orientation program and conflict of interest management system designed to insure the two shareholder nominees served as directors in the best interest of Stelco. Installing the two shareholder nominees as directors was seen by some stakeholders as granting shareholders a primary voice in Stelco's restructuring, where the premise for the filing was that Stelco had become insolvent. It was controversial. Employees and retirees voiced their opposition in court.

The judge supervising Stelco's CCAA proceedings indicated that a failure to take employee and other interests into account would make it difficult for Stelco to exit insolvency proceedings saying "I fear that it would be trying to put Humpty Dumpty back together again". Although there was no evidence of actual misconduct on the part of the two nominee directors, the supervising judge also found that it was appropriate, given prior public

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statements by the two nominee directors, that they be removed from office since there was a reasonable apprehension of bias that they would act in a manner that favoured the interests of Stelco's shareholders in the restructuring. As a result, the supervising judge ordered that the two nominee directors be removed from office.[FN62]

The Ontario Court of Appeal ordered that the two nominee directors be reinstated to Stelco's board on the basis that the lower court did not have the jurisdiction to remove them on the grounds advanced.[FN63] The Court of Appeal noted that the removal of directors on any basis was an exceptional remedy and that courts should generally be unwilling to interfere in the governance process, even when a corporation is subject to insolvency proceedings. Prior to a court making an order to remove directors from office, actual misconduct must have occurred or there must be a sufficient risk of sufficient misconduct to justify the order being made — not merely a reasonable apprehension of bias.

Similarly, in the Hollinger proceedings, the supervising court held that the removal of directors should occur only in exceptional circumstances and courts should exercise great caution before doing so and do so only where there was compelling justification.[FN64]

The Stelco and Hollinger proceedings brought forth complex issues that may have been exceptional at the time. However, both cases have furthered concerns regarding governance issues in distressed circumstances as well as focused attention, in part, on how well directors police themselves and on whether there are adequate processes in place to ensure that governance failures do not occur in distressed circumstances. It would appear that looking to the courts for relief to cure dysfunctional governance circumstances, even in insolvency proceedings, is a last resort and is only to be pursued in exceptional circumstances.

(c) — Replacement

We frequently see a need for change in the composition of the board of directors of distressed corporations, whether during: (i) the decline of the business; (ii) the crisis phase; or (iii) the implementation of a restructuring plan. Particularly during the first two phases of distress, new skills and perspectives are needed; and it is often important to have the ability to assess strategies and operations anew without having been part of their formulation. It is also very helpful to have among the directors of a distressed corporation people who have been through the turmoil of a restructuring before. Their perspectives on process, potential outcomes, and the people necessary to achieve a successful resolution to the distress tend to be much more developed.

In the informal restructurings at both SR Telecom and Atlas Cold Storage, there were changes to the composition of the boards of directors in advance of the pursuit of successful informal restructurings. The timing of these changes was largely dictated by a need for greater control over the activities of senior management and retaining the confidence of stakeholders, but, in both cases, was not dictated by the shareholders/unitholders that had nominated the executive directors in the first place. Non-executive directors acted to effect needed changes in both cases, and independent replacement directors were integral to the results achieved.

In the event that one or more directors resign or are removed from the board of a distressed corporation, determining whether and on what basis replacement directors should be installed is advisable.[FN65] As evidenced by the Stelco proceedings, installing replacement directors that appear to be aligned with one constituency of stakeholders may cause more harm to the enterprise than good. It is a preferred practice to pursue the appointment of replacement directors that are clearly viewed as independent. Not only will it minimize "drag" among stakeholders who may not be supportive of the restructuring initiative, it will also enhance the credibility of whatever plan is ultimately put forward to stakeholders to resolve the distress. In any event, replacement directors installed

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during a distress phase should: (a) possess the skill sets necessary to understand the situation and make an effective contribution to the board; (b) receive the benefit of an intensive orientation program provided by both senior management and external professional advisors; and (c) be capable of devoting the time necessary to the cause. Of course, finding replacement directors while a company is in distress can be challenging. Individuals of the necessary calibre willing to enter into a role with significant financial and reputational risk are not easy to find and even harder to convince to serve.

Replacement of directors by shareholders at an annual or special meeting of shareholders where the corporation is insolvent and subject to court supervision poses its own set of issues. Certainly, the shareholders "are the owners" and ordinarily are entitled to install and change directors, but they own interests in an insolvent company that cannot pay its creditors and has sought court protection. We observe that, in such circumstances, permitting replacement of the directors by shareholders typically leads to destabilization of the enterprise unless done with the concurrence of key creditors or in conjunction with the implementation of a plan acceptable to creditors.

Most successful restructurings include changes to the composition of a corporation's board of directors during the implementation phase when all, or a material number of, directors are replaced to reflect new ownership interests and to install confidence in the restructured enterprise. We observe that, where possible, it is preferable to retain at least one or two independent directors from among the incumbents on implementation (even if only for a year). Their knowledge concerning the corporation and its affairs typically cannot be surpassed and is likely to prove quite valuable during the transition to new ownership and direction. Typically, a number of key stakeholders in the restructuring express interest in influencing the initial composition of the board of the restructured corporation. Sorting through who should have what level of influence on initial board composition can be quite tricky and is typically bound up in the economic negotiations central to achieving a successful outcome.

(d) — Use Recruiters

It can take months to find the right prospective directors, convince them that their help is needed, and assure them that the risks of joining are warranted, particularly in the depths of a corporation's distress. Where time and resources permit, many boards and special committees rely upon third party consultants that specialize in board recruitment to try to advance their searches. Skilled recruiters can be very helpful in: (a) creating an inventory of skills required; (b) matching the inventory against the profiles of current and prospective directors; and (c) where there are gaps, assessing the field of available potential candidates. They can also be very helpful in bringing objectivity to the process when all, or substantially all, of a board is to be changed and a number of key stakeholders express interest in influencing the composition of the board of the restructured corporation.

(e) — Use Interim Boards

In many instances, the formation of a transition board is required to get a distressed enterprise to the point where "long-term" directors will assume the role.[FN66] These transitional boards are not always independent of the stakeholders in a restructuring, so care needs to be exercised in forming transitional boards.

V. — Managing External Influences on Governance

A broad range of stakeholders will exert themselves to attempt to influence the outcome of a restructuring. Senior lenders, private and public debt holders, equipment financiers, suppliers, employees, organized labour, pensioners/retirees, governments, customers, shareholders, and new money providers (e.g., plan sponsors and inter-

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im credit providers) will all clamour to varying degrees for a seat at the negotiating table. They will attempt to influence both the conduct of the distressed corporation's affairs and any proposal put forward by it. Some of those stakeholders will have more influence than others, either based on contractual rights or their functional impact on the corporation, and not all of them will be favourably disposed toward the success of a restructuring attempt or the senior management and directors of a distressed enterprise. This is all the more reason why governance processes become critical during a distress phase to: (a) engage equitably with key stakeholders; (b) successfully manage the corporation's affairs in the best interests of the corporation; and (c) satisfactorily resolve the distress. As observed above, augmentation or substitution of governance processes and participants may be required to manage external influences on distressed corporations as well as to adequately support the restructuring objective.

We observe that most successful restructurings are accomplished by adhering to five primary principles applied consistently to the relationships between distressed companies and their stakeholders:

(a) frequent communication (both intra- and inter-party);

(b) timely and complete disclosure;

(c) enhanced but controlled stakeholder access to information and management;

(d) opportunity for stakeholders to fully assess their options; and

(e) solicitation of stakeholder input into the restructuring process and any proposed plan by independent advisors to the company.

Adhering to these five primary principles typically allows a distressed enterprise to: (a) address its challenges in a timely manner; (b) maintain adequate levels of confidence within and about the distressed business; and (c) deliver a revitalized and competitive company (either through recapitalization or a sale of all or substantially all of its assets) to the stakeholders, if possible.

*1. — **Key Participants***

Whenever distress envelops a business, all those that deal with the business are affected to one degree or another. Of course, some are affected more than others; the interests of those most affected are typically those interests that need to be addressed satisfactorily before the distress can be successfully resolved. To illustrate our observations on practical aspects of dealing with external influences on governance, we have segregated the key participants into the following broad categories:

(a) the Monitor;

(b) significant creditors;

(c) employees/organized labour/pensioners;

(d) governments/regulators; and

(e) new money.

(a) — The Monitor

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In recent years, it has become mandatory for courts supervising CCAA proceedings to appoint a court officer to monitor the affairs of the distressed corporation[FN67] in much the same way that appointing a trustee under the BIA is mandatory in proposal proceedings.[FN68] The Monitor's powers are as set out in the CCAA and the appointment order. They typically prescribe a primary focus to: (a) monitor and report to the supervising court (and thereby to the creditors and other stakeholders) on the business and financial affairs of the company; and (b) advise the distressed company on the development of its restructuring plan. The manner in which the Monitor's powers are exercised has evolved over time as practitioners and courts have gained experience in how a Monitor might best fulfill its duties. Divergent views and practices on the point remain to this day.

As others have addressed the evolution and the scope of the role of the Monitor in a court-based restructuring, we do not propose to do so here.[FN69] However, we do wish to briefly comment on the Monitor's typical interaction with a distressed company and its key stakeholders as a prelude to our observations on best practices for selected aspects of the governance process to manage external influences in both court and non-court based restructurings. For the purposes of the following discussion, where we refer to the Monitor the comments generally apply as well to a trustee under a BIA proposal proceeding or another independent advisor seeking to facilitate an informal restructuring.

The relationship between a distressed company and the Monitor can be complex, variable and capable of generating significant conflict. Until recently, the auditor of a distressed public corporation typically served as its Monitor and tended to serve as financial advisor prior to appointment. The nature of the relationship typically changes as the Monitor: (a) fulfills its statutory and court-ordered duties in respect of all aspects of the distressed company's business and financial affairs; (b) engages directly with key stakeholders on their issues; and (c) exercises independent judgment on what the distressed company is doing and what the Monitor thinks should be done to deal with the circumstances.

This change in relationship and how the Monitor fulfills its role can cause consternation within senior management and the board. It also frequently highlights divergent views on how best to pursue the primary principles of: (a) frequent communication; (b) timely disclosure; (c) enhanced access; (d) stakeholder assessment; and (e) stakeholder input. Resolving this aspect of the relationship requires extensive dialogue between a Monitor, senior management, the directors, and the professionals providing advice to the distressed company to ensure: (a) all are knowledgeable of each other's issues; (b) agreement is reached where possible on steps that need to be taken and on who should take them; and (c) appropriate information is disseminated to stakeholder groups at the right times during the process.

(b) — Significant Creditors

In today's commercial market, a distressed company's creditor base it likely to change substantially from time to time as the distress increases and the parties who initially extended credit to the company are replaced by secondary market participants that buy debt claims. The senior lenders that originated the senior credit facilities may have pursued hedging strategies and "swapped" their debt exposures to third parties (in many cases, when the loans were originally placed and valued at par) or sold their loan positions. Private placement or public debt holders may have decided to exit the credit and traded out of their positions. Trade creditors may have been approached to sell their claims by traders and aggregators promising liquidity for doubtful accounts receivable.

The role that debt holders play in influencing a restructuring has been canvassed elsewhere, and we do not propose to cover it in any detail here.[FN70] However, we note that, in the end, a corporation seeking to work out

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its distress is likely to be "sitting across the table" from a very different group of creditors with: (a) restrictive covenants and obligations owed to them under their agreements; and (b) very different objectives for the company than those who originally granted the credit. These secondary holders of debt tend to have very diverse views on what should be done during a work-out phase and what the ultimate resolution of the distress should be. They may also change among themselves during the course of any restructuring process.

(c) — Employees

Until relatively recently, employees, pensioners, and retirees affected by the decline of a distressed business in Canada were among the last to be considered as a meaningful stakeholder group and were rarely consulted in the decline or its aftermath — unless some form of wage or benefit concession was sought. Although our experience is that senior management and directors were typically genuinely concerned about employee welfare, the concerns of employees were most often first addressed in the distress phase along the lines of: (a) "Can we make payroll?", in acute cases; (b) "How much notice do we have to give if we are going to have to lay-off large numbers and what is it going to cost us?", in moderate cases; and (c) "Is there any way we can access the pension surplus?", in mild cases.

During the past decade, organized labour got organized (as did large groups of salaried workers, pensioners, and retirees) in addressing their positions inside large debtor-in-possession insolvency cases in Canada. Pressures brought forward by these "employee" constituents for a seat at the table has resulted in a significant shift in the consensus-building effort required to successfully implement a restructuring plan, particularly where collective bargaining rights are concerned.[FN71] Aside from that aspect of contemporary labour relations, well-advised employers came to understand that: (a) the viability of a distressed business was frequently predicated on the good disposition and productivity of its labour force; (b) antagonizing or ignoring employees during a restructuring led to unwanted attrition, resentment among those who stayed, and poor customer and supplier relations; and (c) the willingness of employees to contribute meaningfully to the business turnaround was directly proportional to their sense of engagement and fair dealing.

(d) — Governments

Governments and regulatory authorities can be impacted in many different capacities by many different aspects of distressed circumstances. Some significant capacities impacted include:

(a) as a creditor for unpaid source deductions, sales taxes, income tax, and capital taxes;

(b) as a regulator for matters covering the environment, workplace health and safety, and regulated industries (e.g., aviation, telecom, etc.); and

(c) as a fiduciary or administrator for claims that may be made pursuant to legislation creating statutory deemed trusts and liens (e.g., pensions, wages, etc.).

We observe that, in larger or more visible restructuring cases, governmental authorities typically prefer to be "the unseen hand" in the working out of the distress until a solution is achieved. Given the breadth and scope of the many types of claims that governments may hold or represent in connection with a distressed business, it is somewhat surprising that governments tend to be less active in major Canadian insolvency proceedings than their interests might suggest. Of course, in a number of circumstances, governments have surfaced to set boundaries within which restructurings might be completed,[FN72] to press claims on behalf of others,[FN73] or to

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provide financing in order to assist in the revitalization and reopening of business.[FN74]

(e) — New Money

There is nothing like the scent of "new money" in a restructuring to create excitement paradoxically because the prospect of rescue for the business portends the loss of position for many existing stakeholders. New money can come in many forms, but typically it is advanced as one or more of the following: (a) loans for interim financing during the restructuring (so-called "DIP Facilities"); (b) loans for longer term refinancing on plan implementation (so-called "Exit Facilities"); or (c) an equity subscription on plan implementation.

Typically, new money providers require significant levels of input into and representation in the process to complete a restructuring as well as in the governance of the company prior to and upon emergence. We observe that managing the expectations of new money providers concerning their level of influence over the company prior to completion of the restructuring requires skill, diplomacy, and discipline, particularly as senior management and the board fulfill their duties to the corporation with appropriate regard for the interests of existing stakeholders.

2. — Selected Process Points

Most distressed companies strive to get and maintain control of the restructuring process, including: (a) preparation and dissemination of information; (b) development of a restructuring plan; and (c) stakeholder relations. However, as the clamour for position and influence increases among stakeholders, distressed businesses may struggle to maintain control. To temper the tension that typically develops in the restructuring process, the Monitor should attempt to: (a) foster transparency and fairness in the process; (b) engage key stakeholders directly to deal with their information needs and facilitate their participation in the process on a structured basis; and (c) provide information (and potentially advice) to the supervising court, and thereby the stakeholders, on the process and the development of a restructuring plan. The activities of the company and the Monitor on this front need to be highly coordinated to avoid creating greater stress on the business. We offer the following observations on selected practical aspects that can be pursued to manage external influences on governance during a restructuring attempt and minimize the procedural stress on distressed businesses.

(a) — Pre-Event Preparations

The days shortly before and just after a CCAA filing are typically the most chaotic. The demands placed on the distressed company, senior management, and directors during that time are typically far greater than any circumstances they will have faced before or may face again. It is critical that they be well advised and that as much pre-filing planning and preparation as possible be done (usually without a whole lot of time available) to provide for the welfare of the corporation and to maintain the confidence of key stakeholders in the enterprise. This approach typically involves instituting the Operational Protections referred to above and includes: (a) establishing adequate diagnostic and reporting systems; (b) determining sources of liquidity; (c) identifying key stakeholders; (d) preparing a communications plan and platform for its delivery; and (e) engaging with key stakeholders. Well-advised distressed businesses typically rely upon one or more of their counsel, financial advisors, or a CRO to institute this type of activity.

(i) — Establish Adequate Diagnostic and Reporting Systems

Typically in distressed circumstances, information and reporting systems are weak and do not produce the type,

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quality, or quantity of information required or on as timely a basis as needed. It is frequently necessary to augment the enterprise's internal resources with those of external suppliers to develop financial and other information throughout the distressed period. As stated above, establishing adequate diagnostic and reporting systems is fundamental to providing adequate and reliable information concerning the enterprise's business and affairs to stakeholders.

(ii) — Analyze Liquidity

An assessment of the company's likely liquidity over the near to mid term (e.g., short-term cash flow for three months and mid term for up to a year) is imperative in order to determine any financing requirements and how much time the company has to effect a restructuring. The cash flows to be prepared should be subjected to sensitivity analysis and account for the likely "shock" inherent in the distress becoming public, including: (a) constriction of credit; (b) demand for "hostage" payments on outstanding accounts to induce further supply; and (c) loss of customers or delay in receipt of account payments.

(iii) — Identify Key Stakeholders

A qualitative and quantitative analysis of likely key stakeholders should be completed so appropriate constituents can be approached at the right moment and in the right manner in the distress phase. On the creditor front, the right side of the balance sheet needs to be analyzed to determine the amounts and relative sizes of various creditor interests and the nature of their claims, including: (a) whether any claims are secured; (b) which combination of claims can carry or veto a potential restructuring plan; and (c) who holds the claims and the nature of their relationships to the distressed corporation. In addition, a qualitative assessment of "off balance sheet" and contingent claims and interests should be conducted so potential claims of any significance are clearly identified, included in the proposed management of key stakeholder relationships, and provided for in any draft restructuring plan. Similarly, the nature of the company's workforce, retirees, pensioners, and shareholders as well as their likely participation in the ultimate resolution of the distress should be considered. Equally important is a qualitative analysis of the supplier community and the customer base of the business so critical relationships can be understood and provided for.

(iv) — Control All Communications

The importance of a cogent, comprehensive, and compelling communications plan to a distressed business cannot be overstated. All messages communicated externally and internally by a distressed business must be consistent to engender the level of trust, direction, and momentum needed to support a resolution of the distress. In larger and more complex restructurings, consideration should be given to the retention of a professional communications firm to assist; this approach typically decreases communications risk by centralizing communications through one source and provides expertise, media contacts, and a suite of services to effectively "manage the message". Engaging a communications firm as a pre-event matter will typically allow for the development of messages throughout the restructuring process that are tailored to many different constituents for different circumstances but maintain the level of consistency necessary to sustain confidence in the direction and momentum of the company's restructuring plan.

(v) — Engage Key Stakeholders

Essentially, there are two basic approaches that a distressed company can take when dealing with its significant creditors and other key stakeholders: (i) stall for time, attempt to limit disclosure, focus instead on developing a

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"new money" restructuring plan, and then approach creditors and others near the end of the new money discussions; in essence, bet on a positive outcome to those discussions and the risk a failed new money solution may represent to existing stakeholders; or (ii) approach significant creditors and other key stakeholders relatively early in the distress phase to bring them "into the tent" to understand the nature and extent of the distress, solicit their input as to what steps might be taken to address the distress, and build consensus to a proposed action plan to resolve the distress. There are, of course, variations on and combinations of both the "new money" and "consensual" approaches.

We observe that there has been a recent trend in distressed circumstances towards focusing too extensively only on the "new money" approach and attempting to bypass existing stakeholders. We think this is short-sighted as it does not maximize opportunities: (a) to manage the distress; (b) to create potential solutions; or (c) to build the trust and consensus necessary to achieve a satisfactory resolution. Existing stakeholders are generally already familiar with the business and can represent potential sources of capital, supply of products and services, or referrals the distress company requires. If "frozen out" of the restructuring effort, existing stakeholders are typically destabilizing as they do not have much, if anything, that is positive to say about the situation. They typically have many points of contact within the company's employee, creditor, supplier, and customer communities and will readily share their negative views, thus increasing the chaos enveloping a distressed company and scaring off potential sources of new capital. Ultimately, the company will need a vote of confidence from existing stakeholders to resolve its distress, so starting off by asking for that vote while giving existing stakeholders "the straight-arm" is not a preferred approach. Although both strategies have been employed, pursuing a consensual approach provides a better chance at a constructive, solutions-based approach to a restructuring that is less stressful on the business and less expensive to implement.

(b) — Post-Event Conduct

Once inside a formal insolvency proceeding, effectively managing internal governance aspects and external influences on governance typically becomes somewhat easier as: (a) the level of professional support rises; (b) full disclosure of the circumstances facing the distressed business is made; (c) stakeholders are readily identified; (d) the court's and stakeholders' expectations as to activities set; and (e) the timetable to accomplish many aspects of the restructuring is established. Most cases then fall into a rhythm of activity that can be harnessed to the company's advantage and used to discipline participants. We offer the following observations on certain aspect of the process that may serve as helpful techniques to be pursued in working through the phases of a restructuring.

(i) — The Monitor's Role

The Monitor has a significant role to play in any court-based restructuring. Starting early in the process, the Monitor should clearly challenge the company to conduct a process that achieves the highest governance standards for the five primary principles previously set out, working constructively with its existing stakeholder group. If the Monitor is seen to be acting independently of the company and taking stakeholder views and concerns seriously, we observe that there is greater opportunity for the restructuring to be handled consensually and expeditiously with the benefit of input from key stakeholders. This really is just good business as stakeholders (i.e., creditors and employee groups, in particular) have the ability to create greater market uncertainty for the company by bogging the process down rather than allowing the company to move forward with the restructuring.

The Monitor should be present in most instances and have the ability to address the company's board of directors

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and any special committee established to oversee the restructuring efforts at each of their meetings. This will allow the Monitor to be apprised of material issues as they arise and allow directors to solicit the views and input of the Monitor, particularly regarding matters affecting the court process or key stakeholders. The Monitor's attendance at board meetings can help advance critical issues and test proposed outcomes before they become too advanced.

We recommend more frequent Monitor communications with stakeholder groups generally (coordinated with the company as to confidentiality, timing, message, and the like) and more frequent issuance of reports by Monitors in that regard. Encouraging key stakeholders to deal with an experienced Monitor as a mediator/facilitator can take much of the emotion out of the situation, particularly if the Monitor is viewed as being independent.

Not infrequently, the Monitor will prepare an estimated liquidation value of the company in order to compare values to be received by creditors if the restructuring plan is approved. We observe that a liquidation analysis is best done under the supervision of the Monitor as opposed to a financial advisor retained by the debtor. This is particularly so where a Monitor's recommendation on the restructuring plan is to be contained in an Information Circular as a litmus test of the overall fairness of the plan. As a corollary, the Monitor should conduct an open and transparent process with well-established timelines to call for claims early in the restructuring proceedings, as the size of the claims pool will have a direct impact on creditor recovery and, ultimately, a successful vote on the company's restructuring plan.

(ii) — Use Disclosure and Communication Plans

There is a natural loss of confidence among key stakeholders of a distressed business. Getting that confidence back and keeping it takes real work; losing it a second time is very difficult to surmount. In the clamour for position and influence that surrounds a restructuring, one of the techniques that can be used effectively to engender among key stakeholders confidence that their issues will be addressed (but that time to address those issues is needed) is to establish a comprehensive disclosure plan and communicate its essence to key stakeholders under the communications plan discussed above. Ultimately, most restructurings succeed or fail on three critical initiatives: (i) the execution of comprehensive disclosure and communication plans; (ii) the conduct and resolution of the claims process; and (iii) the type and success of any reorganization and recapitalization efforts. Some of the key elements of an effective disclosure plan are listed below.

1. Revisiting and revising the company's strategic plan as well as preparing supporting documentation in that regard, including forecasts/business plans and contractual information, and making it available in a data room (it will be necessary for recapitalization or sale efforts as well as stakeholder due diligence in any event). Ideally, the company should be prepared both on strategy and information disclosure before stakeholder information discussions commence.

2. Establishing dialogue and creating formal information channels with key stakeholders (or steering committees) and their legal and financial advisors that will lead restructuring efforts for significant creditors and other key stakeholders. This is likely to be complicated by debt trading activity, so entering into confidentiality and trading restriction agreements with advisors and principals may be required (and could be difficult as principals may wish to remain free to trade). Early discussions will provide benefits that include understanding creditor expectations and likely information requests. Establishing these protocols will take time and, therefore, will give the company breathing space, but at the same time will start rebuilding relationships on a positive basis.

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3. Establishing open lines of communication for regular dialogue at various levels within each key stakeholder organization. Feedback from all levels can be critical to the success of the process.

4. Ensuring that only meaningful information is provided to stakeholders at a time that is relevant to ensure that the process continues to move forward. Recognize that there is a trade-off between timeliness and completeness of information and put only necessary information in the hands of the appropriate stakeholders; too much or unnecessary information can slow the process down.

5. Scheduling time to "walk" significant creditors and other key stakeholders and their advisors through the strategic plan, the data room content, and information requests to ensure everyone is on the same page from the beginning (balancing the amount and appropriateness of information requested) and giving parties direction before due diligence goes awry.

6. Scheduling initial meetings, but allowing for follow-up directly between advisors and management (at times convenient to management, who should not be unduly distracted from operations). Attempting to control every meeting has a delaying impact and may leave the impression that information flow is being restricted unduly.

7. Scheduling time for further presentations by applicable company personnel to key stakeholders and their advisors at appropriate "milestones" or where material changes occur within the restructuring process. This allows parties to reassess positions and direction as well as obtain feedback before going too far forward.

8. Ensuring the data room contains the same information for all parties for consistency of message.

9. Soliciting feedback and comparing stakeholder analysis of company information to ensure basic facts are consistently understood, even though individual stakeholder conclusions on their importance may differ.

10. When management is considering its initial options and strategies around its restructuring plan, conducting high-level exploratory discussions with key stakeholders to ensure the approach ultimately taken will be generally acceptable.

Following a clearly articulated disclosure plan and managing a communications plan closely should have a direct and positive impact on how key stakeholders view the company and assess options put forward for its restructuring.

(iii) — Stakeholder Interaction

There are a number of different approaches to managing stakeholder interaction in distress situations, but most of them ultimately redound to: (a) an exclusive approach; or (b) an inclusive approach. The exclusive approach tries to isolate parties and keep them apart so the company can negotiate individually with key stakeholders or groups of stakeholders. This may be possible with a widely disbursed creditor group or for relatively short periods of time, and it has been done successfully in several instances. However, even if the company attempts to implement an exclusive approach, the reality is that stakeholders will get together to discuss and share views and possible solutions, and not always with a result the company may want. We observe that adopting an inclusive approach that facilitates stakeholder communication typically provides valuable feedback to the company when

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it is crafting its restructuring plan and, ultimately, results in a more robust restructuring plan with greater receptivity among stakeholders.

(iv) — Establish Creditor Committees

In the right situation, establishing a committee of key creditors early in a complex restructuring can result in quicker resolution of issues and be more cost efficient than trying to deal with multiple parties claiming to represent various creditor groups. Establishing a creditors' committee can allow for a single point of representation of what otherwise would be large numbers of interested parties that management and restructuring advisors would have to contact individually. The creditors' committee should serve as a form for obtaining ongoing feedback on both the progress of the restructuring as well as any proposed plan. It will typically serve as a body prepared to make a recommendation on the appropriateness of a restructuring plan to a broader constituency.

For example, when Laidlaw Inc. (Laidlaw) started experiencing financial difficulties in the late 1990s, an approach to stakeholder communications appears to have been taken at first that did not bring lenders and public debt holders further into the process. As Laidlaw's circumstances deteriorated, the debt holders lost confidence in the company's ability to deal with the situation, and the restructuring stalled. Through the timely appointment of a CRO and reorientation of its key relationships, Laidlaw's communications with two of its most significant stakeholder groups improved markedly and helped turnaround a floundering restructuring.

In the AT&T Canada proceedings, the company agreed to the creation of a noteholders' committee early on and obtained an order allowing it to pay the legal and financial advisers to that committee out of corporate funds. The creation of the noteholders' committee greatly assisted in developing a restructuring plan that would be acceptable generally to the largest group of creditors affected by the restructuring. Engaging with the committee allowed the company to focus on discussions with one representative group as opposed to embarking on premature, expensive, or unwieldy campaigns to reach consensus with disparate interests, and it substantially accelerated the negotiations toward an acceptable plan.

(v) — Employees

Employees should be kept informed, on a timely basis, of the restructuring process as well as be cognizant of the key messages. Employees are typically the first point of contact for most of the stakeholders affected by the restructuring. Informed employees can add considerably to a successful outcome by maintaining supplies of products, driving sales and cash collections from customers, and reducing the noise created by competitive market forces that will impact the company. Poorly informed employees can be very damaging to the restructuring effort.

Where an operational restructuring is important to the success of the overall restructuring plan, dealing with employees (unionized or not) should be no less important than with other key stakeholders. Once the company has assessed what may need to be done operationally, subject to confidentiality issues, discussions should commence with key employee representatives to walk them through the plans and solicit input (there may be better alternatives from the "shop floor"). Employee representatives will need to do their due diligence and ultimately sell it to employee groups (particularly in a union situation). It should go without saying that, unless employees understand the company is a "burning platform", employee "buy-in" to proposed changes will be low. Any headcount reductions need to be closely managed and communicated clearly so that the job security concerns of retained employees are minimized.

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(vi) — Governments

Although governmental authorities typically prefer to be "the unseen hand" in the working out of a distressed situation, in larger or more visible restructuring cases they should be kept apprised of the status of restructuring efforts on a timely basis. In significant cases, governments may surface visibly to influence either the conduct of the process or the actual outcome of the restructuring proceedings.[FN75] Generally, it is not advisable to bring governmental authorities visibly into discussions early in a restructuring as other stakeholders may become hampered by false hopes for governmental assistance.

(vii) — New Money

Raising new capital can be critical to the success of a restructuring, so, too, can the process by which new money is sought. We observe that obtaining prior court approval to any new capital solicitation process minimizes potential disruptions to the process and the company's affairs as well as makes for more ready participation by potential sources of funding.

The developing trend of larger Canadian restructurings using a mix of "stalking horse" and competitive capital markets solutions, without fully clarifying what the rules of engagement are for the stalking horse bidder or any other participants upfront, is not encouraging. Uncertainty in process usually leads to a less competitive situation, as many new money providers are reluctant to participate and bear the time and expense if the process is not well defined or is subject to potential manipulation.

Information requirements of the DIP Facility provider should be readily capable of production, and covenants should not be tripped under any scenario. Any proposed DIP Facility should be assessed on how it may impact potential Exit Facilities for a new capital structure. Consideration should also be given to determining whether the DIP Facility provider can also become the Exit Facility provider, as this may provide positive momentum toward the success of any restructuring plan.

The process for recapitalizing the balance sheet in a restructuring should be similar to that applicable in non-distressed circumstances, except that there may be a greater need for speed and a court process supervising the overall restructuring must approve the process and outcome. A level playing field and a transparent process must be inherent in the refinancing attempt. A clear message must be sent as to the focus of the capital-raising effort (e.g., just finding new money, obtaining industry expertise, and/or forming strategic partnerships). Key aspects of any refinancing solicitation should include:

(a) comprehensive confidentiality protections;

(b) set minimum criteria bidders need to meet;

(c) standard financing templates and offering documents prepared and issued to all potential participants;

(d) if a stalking horse bid is used to "make the market", it should contain appropriate deal protections (e.g., expense re-imbursement, break fees, etc.) and a "fiduciary out" for the company's directors so the bid can be trumped by a better bid in a clearly defined manner;

(e) set key dates for offers/bids to be submitted and for completion of negotiations;

(f) an independent analysis of any new money proposals by the Monitor to assess their impact on the com-

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pany's business, the restructuring, and the potential recoveries for creditors; and

(g) court approval of any successful bid to "quiet the waters" going forward and create stakeholder confidence in the process to be followed to complete the restructuring.

VI. — Conclusion

Governing distressed enterprises in Canada is not an easy matter. In distressed circumstances, there are many aspects of governance that require substantial time and attention over and above that which would ordinarily be devoted to them. There are probably as many perspectives on what an appropriate governance approach in distress circumstances ought to be as there are people involved in the process. Although the approaches, techniques, and observations offered above may not apply in every circumstance, on balance, we believe they are sound for managing selected governance aspects and should be applicable generally in most distress circumstances facing Canadian enterprises.

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FN2. See, e.g., "Where Were the Directors? Guidelines for Improved Corporate Governance in Canada" (Report of the Toronto Stock Exchange Committee on Corporate Governance in Canada, December 1994).

FN3. See, e.g., Janis P. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations*, (Toronto: University of Toronto Press, 2003).

FN4. For example, the restructurings of each of Eaton's of Canada Limited, Cadillac Fairview Limited and Bramalea Limited.

FN5. R.S.C. 1985, c. C-36.

FN6. R.S.C. 1985, c. B-3.

FN7. See, e.g., Janis P. Sarra, "Wise People, Fiduciary Obligation and Reviewable Transactions, Directors' Liability to Creditors" in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2003* (Toronto: Thomson Carswell, 2004) at 67-119 [Sarra]. See also, Jacob S. Ziegel, "Corporate Governance and Directors' Duties to Creditors: Two Contrasting Philosophies" in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2003* (Toronto: Thomson Carswell, 2004) at 133-167 [Ziegel]. See generally, Janis P. Sarra, ed., *Annual Review of Insolvency Law 2003* (Toronto: Thomson Carswell, 2004) for other helpful articles on point.

FN8. For example, the complex and lengthy court-based restructurings of The Loewen Group Inc., Laidlaw Inc., and Philip Services Corporation.

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FN9. See, e.g., *Royal Oak Mines Inc. Re* (1999), 11 C.B.R. (4th) 122 (Ont. Gen. Div. [Commercial List]). See also, Andrew J. F. Kent & Wael Rostom, "The Auditor as Monitor in CCAA Proceedings: What is the Debate?" in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2003* (Toronto: Thomson Carswell, 2004) at 197-210. (This article provides a useful discussion on this development.)

FN10. See, e.g., *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 27 C.B.R. (3d) 148 (Ont. Gen. Div. [Commercial List]). See also, Jodi Mason, "Recent Challenges to the Interim Receiver" in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2002* (Toronto: homson Carswell, 2003) at 419-458.

FN11. See M. Forte, "The Recognition and Roles of the Chief Restructuring Officer in Canadian Insolvency Proceedings" (2001), 14 Comm. Insol. R. 4., for a useful discussion on this development.

FN12. The Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals, Joint Task Force on Business Insolvency Law Reforms, "Report" (March 2005) [Joint Task Force].

FN13. Canada, Parliament, Senate, Standing Senate Committee on Banking, Trade and Commerce, "Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies Creditors Arrangement Act* Report" in *Report of the Standing Senate Committee on Banking, Trade and Commerce* (Ottawa: November 2003) (Chair: Richard H. Kroft).

FN14. Joint Task Force, "Supplemental Report" (July 2005).

FN15. S.C. 2005, c. C-47.

FN16. A point made by the IIC in its position paper submitted to the House of Commons Standing Committee on Industry, Science and Technology in November 2005 and by the Legislative Review Task Force (Commercial) jointly appointed by the IIC and CAIRP in its October 2005 Report.

FN17. Edward A. Sellers, Natasha J. MacParland & F. James Hoffner, "Governance of the Financially Distressed Corporation in Global Capital Markets: Selected Aspects of the Financing and Governance of Canadian Enterprises in Cross-border Workouts", in Janis P. Sarra, ed., *Corporate Governance in Global Capital Markets* (Vancouver: UBC Press, 2003) at 297-344 [Sellers et al.].

FN18. For a useful account of many of those decisions, please see Sarra, *supra*, note 6 and Ziegel, *supra*, note 6.

FN19. *People's Department Stores Ltd. (1992) Inc., Re*, [2004] 3 S.C.R. 461 (S.C.C.) [*Wise*].

FN20. See, e.g., Janis P. Sarra, "The Oppression Remedy: The Peoples Choice" in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2005* (Toronto: Thomson Carswell, 2006) at 111-156 [Sarra II].

FN21. R.S.C. 1985, c. C-44.

FN22. 11 U.S.C. (1988).

FN23. *Calpine Canada Energy Ltd., Re* (December 20, 2005), Doc. Calgary 0501-17864 (Alta. Q.B.).

FN24. D.S. Morritt, S. Bjorkquist & A.D. Coleman, *The Oppression Remedy* (Aurora, Ontario: Canada Law Book Inc., 2004); Sarra, *supra*, note 6; and Sarra II, *supra*, note 19.

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FN25. The Trustee also brought claims against counsel to the bankrupt, who then brought third party claims against counsel to the acquirer.

FN26. See, e.g., Geoffrey B. Morawetz, "Under Pressure: Governance of the Financially Distressed Corporation" in Janis P. Sarra, ed., *Corporate Governance in Global Capital Markets* (Vancouver: UBC Press, 2003) at 275-296. See also, Sellers et al, *supra*, note 16.

FN27. For useful discussions on decision-making processes, see Glen Whyte, "Make Good Decisions by Effectively Managing the Decision-making Process", in Edwin A. Locke, ed., *Basic Principles of Organizational Behaviour: A Handbook* (Oxford: Blackwell, 2000) at 315-330; Michael Useem, "How Well-Run Boards Make Decisions", *Harvard Business Review* (Cambridge: Harvard Business School Publishing, 2006), at 130-138.

FN28. More recently, the imposition of the changes and reporting requirements mandated by Ontario *Securities Act*, R.S.O. 1990, c. S-5, Part XXIII.1; and Regulation 1015, R.R.O. 1990, thereunder; as well as s. 404 of the so-called "*Sarbanes-Oxley Act*" have made qualified resources even more scarce and very expensive.

FN29. See, e.g., Michael W. Peneguire & Russell Hayman, "New Issues for Board Meeting Minutes", (The Corporate Board, 2006).

FN30. See, e.g., CBCA, s. 120.

FN31. See, e.g., CBCA, s. 123.

FN32. *Supra*, at note 18.

FN33. See, e.g., CBCA, s. 123(4). See also Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16, s. 135(4).

FN34. *Catalyst Fund General Partner I Inc. v. Hollinger Inc.* (2004), 1 B.L.R. (4th) 186 (Ont. S.C.J.); affirmed (2006), 15 B.L.R. (4th) 171 (Ont. C.A.) [*Hollinger*].

FN35. For a similar view, see Ontario, Ministry of Finance, *Five Year Review Committee Final Report — Reviewing the Securities Act (Ontario)*, (Toronto: Queen's Printer for Ontario, 2003).

FN36. See, e.g., *Consumers Packaging Inc., Re* (2001), 2001 CarswellOnt 3331 (Ont. S.C.J. [Commercial List]) [*CPI*]; *Laidlaw Inc., Re* (August 10, 2001), Doc. Toronto 01-CL-4178 (Ont. S.C.J. [Commercial List]); *Loewen Group Inc., Re* (June 1, 1999), Doc. Toronto 99-CL-3384 (Ont. S.C.J. [Commercial List]); and *Algoma Steel Inc., Re* (2001), 2001 CarswellOnt 1999 (Ont. S.C.J. [Commercial List]).

FN37. Sellers et al, *supra*, note 16.

FN38. For a list of the types of conduct matters that should be within the scope of a liability audit, see Sellers *et al*, *supra*, note 16, at 328-329. See also, Janis P. Sarra & Ronald B. Davis, *Director and Officer Liability in Corporate Insolvency: A Comprehensive Guide to Rights and Obligations* (Markham, Ontario: Butterworths, 2002) at 217-225.

FN39. R.S.C. 1985 (5th Supp.), c. 1.

FN40. R.S.C. 1985, c. E-15.

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FN41. *Supra*, note 38.

FN42. See, e.g., *Kohanski v. St. Paul Guarantee Insurance Co./Cie d'assurance St. Paul Garantie* (2005), 2005 CarswellOnt 7900 (Ont. S.C.J.); reversed (2006), 207 O.A.C. 13, 2006 CarswellOnt 202 (Ont. C.A.); but see *Markham General Insurance Co. (Liquidator of) v. Bennett* (2006), 2006 CarswellOnt 3058, [2006] O.J. No. 1989, 38 C.C.L.I. (4th) 45, 20 B.L.R. (4th) 104, 23 C.B.R. (5th) 193, 81 O.R. (3d) 389 (Ont. S.C.J.); additional reasons at (2006), 2006 CarswellOnt 4174, 23 C.B.R. (5th) 203 (Ont. S.C.J.).

FN43. A development that was first discussed by Douglas I. Knowles & H. Alec Zimmerman, "Further Developments and Trends in *Companies' Creditors Arrangement Act*: 1992" (IIC Third Annual General Meeting, 1992); and Douglas I. Knowles, Edward A. Sellers & H. Alec Zimmerman, "Further Developments and Trends in *Companies' Creditors Arrangement Act*: 1994" (IIC Fifth Annual General Meeting, 1994) at 47-50 [Knowles, Sellers and Zimmerman].

FN44. Knowles, Sellers, and Zimmerman, *supra*, note 42.

FN45. CCAA, *supra*, note 4, s. 11.5; BIA, *supra*, note 5, s. 69.31.

FN46. See, e.g., *CPI*, *supra*, note 35; *Canada 3000 Inc., Re* (November 8, 2001), Doc. Toronto 01-CL-4314 (Ont. S.C.J. [Commercial List]) [*Canada 3000*]; and *AT&T Canada Inc., Re* (October 15, 2002), Doc. Toronto 02-CL-4715 (Ont. S.C.J. [Commercial List]) [*AT&T Canada*].

FN47. See, e.g., *CPI*, *supra*, note 35, as an example of circumstances where a negotiation occurred and *Canada 3000*, *supra* note 45, where negotiation did not.

FN48. See, e.g., *CPI*, *supra*, note 35; and *AT&T Canada*, *supra*, note 45.

FN49. *Canada 3000*, *supra*, note 45.

FN50. *Air Canada, Re* (2003), 2003 CarswellOnt 2464 (Ont. S.C.J. [Commercial List]).

FN51. *Afton Food Group Ltd., Re* (July 16, 2004), Doc. Toronto 04-CL-5491 (Ont. S.C.J. [Commercial List]).

FN52. CCAA, *supra*, note 4, s. 5.1(1), (2), (3) and (4); BIA, *supra*, note 5, s. 50(13), (14), and (15).

FN53. CCAA, *supra*, note 4, s. 18.2; BIA, *supra*, note 6, s. 60(1), (1.1), (1.2), and (1.3).

FN54. As happened in conjunction with the "financial statement misstatement", subsequent resignation of the C.E.O. and C.F.O., appointment of interim directors, and ultimate reconstitution of the directors and senior management of Atlas Cold Storage Income Fund [Atlas Cold Storage].

FN55. *Ibid.*

FN56. As happened in connection with the special committee investigation at Hollinger International Inc., resulting in a report of hundreds of pages.

FN57. As happened in connection with *CPI*, *supra*, note 35, and *AT&T Canada*, *supra*, note 45.

FN58. This was the case at Atlas Cold Storage for complicated reasons. In those circumstances, an independent

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audit firm was engaged to oversee the existing auditor's review.

FN59. William A. Dimma, *Excellence in the Boardroom*, (Toronto: John Wiley & Sons Canada Ltd., 2002) at 194-197.

FN60. See, e.g., CBCA, ss. 118, 119.

FN61. *Stelco Inc., Re* (2004), 2004 CarswellOnt 483 (Ont. S.C.J. [Commercial List]).

FN62. *Stelco Inc., Re* (2005), 7 C.B.R. (5th) 307 at 310 (Ont. S.C.J. [Commercial List]); additional reasons at (2005), 2005 CarswellOnt 743 (Ont. S.C.J. [Commercial List]); reversed (2005), 2005 CarswellOnt 1188 (Ont. C.A.).

FN63. *Stelco Inc., Re* (2005), 9 C.B.R. (5th) 135 (Ont. C.A.).

FN64. *Hollinger*, *supra*, note 33.

FN65. The fundamental principles eschewed by the Canadian Coalition for Good Governance on how to construct a board are: (a) recruit effective, committed, and independent directors; (b) clearly design the roles and responsibilities of the board, its chair, and committee chairs; (c) continually strive to improve board performance through evaluation and peer review; and (d) have directors that invest significantly in the business, without compromising their independence. Some of these good governance practices may take more time to evolve in a distress situation, but the underlying principles are fundamentally sound.

FN66. As happened in connection with Atlas Cold Storage.

FN67. CCAA, *supra*, note 4, s. 11.7.

FN68. BIA, *supra*, note 5, s. 50(2).

FN69. See, e.g., Douglas I. Knowles, "To Liquidate or Restructure under the CCAA? The Monitor's Conflicting Duties." in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2005* (Toronto: Thomson Carswell, 2006) at 95-110.

FN70. See, e.g., Janis P. Sarra, "Governance and Control: The Role of Debtor in Possession Financing under the CCAA", in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2004* (Toronto: Thomson Carswell, 2005) at 119-171; Jeffrey B. Gollob, "Distressed Debt Lenders and Their Impact on Restructurings and Workouts in Canada", in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2004* (Toronto: Thomson Carswell, 2005) at 173-186.

FN71. See, e.g., Steven Wahl, "Bankruptcy and Insolvency: Highstakes Poker at the Collective Bargaining Table", in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2004* (Toronto: Thomson Carswell, 2005) at 243-253.

FN72. As happened, for example, in conjunction with Stelco Inc.'s CCAA proceedings when the Province of Ontario indicated that it would not be amenable to a restructuring plan that failed to address certain pension deficits in a manner satisfactory to the Province.

FN73. As happened, for example, in connection with a "lift of stay" motion brought by the Government of

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Yukon to permit the registration and perfection of certain types of lien claims against Curragh Inc.

FN74. As happened, for example, in conjunction with a sale and reopening of a pulp mill in the aftermath of the bankruptcy of St. Anne-Nakawic Pulp Company Ltd.

FN75. See, e.g., the Restructurings of Curragh Inc., Skydome Inc., and Stelco Inc.

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TAB 7

IIC-ART 2008-4

Insolvency Institute of Canada (Articles)

— Canadian Business Restructuring Law: When Should a Court say "No"? — Andrew J.F. Kent, Wael Rostom, Adam Maerov & Tushara Weerasooriya[FN1]

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For the past twenty-five years the Canadian business insolvency system has moved from focusing on sale proceedings conducted principally for the direct benefit of creditors to reorganization proceedings controlled by the debtor. Many of the extraordinary powers granted to debtors to effect such reorganizations were first authorized by the exercise of judicial discretion rather than as a result of legislative reform. However, the statutes and case law give little guidance on governance issues, so by default, the courts have looked to corporate law developed for solvent entities acting without extraordinary powers. The courts have shied away from policing the exercise of those extraordinary powers (a number of which will soon be codified) and have proactively limited the role of the creditors in restructuring proceedings, fearing that empowering the creditors would tend to put the "success" of the restructuring proceedings at risk. As a result, Canada now has a system that encourages reorganizations by the debtor but has few meaningful checks and balances. It is clear that the implications of this result have not been weighed in the balance. Unless one believes that any "restructuring" is inherently better than the alternatives, there are good reasons to be concerned about these implications.

Au cours des vingtcinq dernières années, le système canadien d'insolvabilité commerciale a évolué, passant d'un système axé sur des opérations de vente réalisées principalement à l'avantage direct de créanciers à un système axé sur des réorganisations contrôlées par le débiteur. Bon nombre des pouvoirs extraordinaires conférés aux débiteurs pour réaliser des réorganisations ont été d'abord autorisés suite à l'exercice de pouvoirs judiciaires discrétionnaires plutôt que par suite à des réformes législatives. Les lois et la jurisprudence encadrent peu les questions de gouvernance en ce domaine; par conséquent, les tribunaux se sont inspirés sur ces questions du droit des sociétés, rédigé pour des entités solvables agissant sans pouvoirs extraordinaires. Les tribunaux ont évité de réglementer l'exercice de ces pouvoirs extraordinaires (dont un certain nombre seront bientôt codifiés) et ont limité de façon proactive le rôle des créanciers dans les instances de restructuration, par crainte que ceuxci en compromettent la réussite. Par conséquent, le Canada dispose maintenant d'un système qui encourage les réorganisations par le débiteur mais compte peu de mécanismes régulateurs. Il est clair que les effets de cet aboutissement n'ont pas été suffisamment évalués. à moins que l'on ne soit d'avis que toute « restructuration » est, de par sa nature, préférable aux autres solutions de rechange, il existe de bonnes raisons de procéder à cette évaluation.

1. — Introduction

Over the past few years the primary focus of insolvency law reform efforts has centred around the introduction of Bill C-55, now enacted as *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*[FN2] (the "*Reform Act*"). First passed by the House of Commons in November, 2005, the

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Reform Act has undergone an unusual journey towards proclamation. Due to a number of technical deficiencies arising from the draft as passed, the *Reform Act* was not proclaimed into force after it was passed. Bill C-12 [FN3] which corrected many technical defects contained in the *Reform Act* was passed by the House of Commons and received royal assent in December, 2007. Although the *Reform Act* still remains the subject of Senate committee hearings, the *Reform Act*, as amended by Bill C-12, is scheduled to be proclaimed into force during 2008.

The *Reform Act* represents the first major statutory reform initiative since the 1997 amendments to Canadian bankruptcy law. On their face, a substantial number of the amendments to business bankruptcy law contained in the *Reform Act* represent a codification of practices developed over the last ten to fifteen years. For example, the *Reform Act* expressly provides for debtor-in-possession financing ("DIP financing"), creates a scheme for disclaiming or assigning executory contracts and provides for authority to conduct a sale of a business as part of a restructuring proceeding.

As a result of the lack of statutory guidance, much of Canadian restructuring law was developed on an ad hoc basis through the use of judicial discretion and an increasingly broad interpretation of the Court's inherent or implied jurisdiction. Codifying existing restructuring practices represents a move towards a more black-letter law approach to restructuring in Canada. This may tend to support what appears to be a recent retrenchment of the use of inherent jurisdiction by the Courts.

Perhaps more fundamentally, the *Reform Act* signifies an express acceptance of a rescue or rehabilitative philosophy of insolvency law. Certainly, as an historical matter, insolvency law in Canada (and the United Kingdom from which much early Canadian commercial insolvency concepts were derived) has consistently supported an insolvency system that was both an efficient method of distributing assets among creditors and a vehicle for achieving certain social and economic policy goals.[FN4] Nevertheless, until recently Canada's commercial insolvency legislation focused primarily on setting out a scheme for the redistribution of the proceeds of the assets of a failed enterprise in a manner that was fair and equitable.[FN5] The *Companies' Creditors Arrangement Act [FN6]* (the "*CCAA*") (enacted in 1933) was available to effect the restructuring of insolvent companies outside of bankruptcy. However, it was not until the 1980's that the spirit of the rescue culture resurrected this largely unused statute and elevated it to Canada's primary restructuring statute for large enterprises.[FN7]

The recent reforms focus principally on establishing a framework for restructuring by giving a debtor the tools (such as DIP financing) necessary to effect a successful restructuring of its business and debts. The *Reform Act* is noticeably silent in providing debtors with any guidance and direction as to how to use these tools to reach a successful result and, perhaps more importantly, what is a successful restructuring. Similarly, creditors, monitors, and other insolvency protagonists operating within this framework have little basis for establishing what the debtor's objective should be and consequently have no real ability to act as an appropriate check on the restructuring process.

Unfortunately, there is little guidance to be found in the jurisprudence beyond basic statements relating to the purpose of the *CCAA*. Courts have generally held that the purpose of the *CCAA* is "to preserve an insolvent company as a viable operation and to reorganize its affairs to the benefit not only of the debtor but of the creditors." [FN8] Implicit in this purpose is the belief that restructurings have such economic and social value as to render them preferable to liquidation or sale. It has been argued that from a macroeconomic perspective, there is little to be gained in liquidating viable enterprises that are experiencing temporary financial hardship.[FN9]

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The flaw in these types of superficially attractive but vague statements is that they lack a fundamental theoretical basis upon which we can formulate concrete objectives. In the United States there are competing theories of bankruptcy law. For example, one theory, the creditor's bargain theory,[FN10] focuses on the position and expectations of creditors. Alternatively, we could adopt Professor Warren's position that bankruptcy reorganization should preserve the debtor's business for the benefit of many constituencies, such as employees, customers, and suppliers and judge the success of a restructuring by how many jobs were saved or customer/supplier relationships maintained.[FN11]

It is unclear what theory informs Canadian insolvency laws. Is the primary value simply to get to a restructuring deal, whatever that deal may be?

Consider for instance the position of debtor's counsel advising its client on the eve of a *CCAA* filing. Should counsel tell the debtor's board of directors that post-filing it should look only to protection of shareholder interests and the enterprise as a whole because Canadian corporate law does not recognize a shift in the board's duties to creditors within an insolvency? Should counsel advise the debtor to terminate its employees and make termination and severance payments before the filing on the basis that the employees, particularly unionized employees, are more likely to put up an organized fight, while unsecured creditors have less capacity to advance their interests? Should counsel assure the debtor that in all likelihood any plan put forward by the debtor will be approved by the court (even where substantive rights of third parties, like landlords, are compromised or unilaterally changed), as long as the result is said to be better than a liquidation? There are no simple answers to these questions and counsel, whose primary duty is to serve the interests of the client, must advise the debtor to act in a manner that is advantageous to the debtor's interests, without regard to the consequences such actions may have on the restructuring system as a whole.

The absence of definitive guidance and rules governing the behaviour of the debtor in an insolvency has resulted in the transfer of the governance burden (perhaps unfairly) to the judiciary who must maintain the integrity of the system through the exercise of judicial discretion and inherent jurisdiction. However, the nature of the Canadian judicial process is such that it requires courts to adjudicate specific disputes between particular parties. While a court can and must be relied on implicitly to adjudicate such matters in a manner that is fair and just, the case-bycase consideration of issues is not always conducive to promoting high level policy objectives. For example, the decision of a court to approve a particular course of conduct while justifiable in the circumstances, may lead to injustices in the future. In the absence of specific legislative rules that speak to when and, in what circumstances, such conduct should be approved, that one decision of the court is itself elevated to a "rule" which must be followed or at least considered in every subsequent case. The result is that courts have become bound by a set of decisions made (in large part) to address very specific disputes and facts and which together do not necessarily reflect the principles that would collectively have been agreed upon by parties designing the system.

What is clear is that when it comes to the governance of parties participating in a restructuring process, particularly the debtor, there is a gap in the legislation. While this gap has, to a certain extent, been filled by corporate law and by the common law or the civil code on an ad hoc basis, it does not provide the "necessary degree of predictability and consistency in the application of the law, which is essential to investors, creditors, employees and other interested parties in developing a successful restructuring plan."[FN12]

The purpose of this article is to discuss the existing parameters that limit a debtor's use of the restructuring powers now available to it. Or put another way, when should a court say "no" to a debtor?

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2. — The Debtor

Since most Canadian businesses involve corporations, a logical place to start the analysis of the rules that should govern the debtor is to consider the principles that apply to the governance of corporations.

In Canada, corporate governance laws are based on the *Canada Business Corporations Act*[FN13] (the "*CBCA*") and that Act's provincial counterparts, as well as on common law principles derived from case law and rules that are imposed by stock exchanges and provincial securities laws. The management of corporations is overseen by the directors, who under section 102(1) of the *CBCA* are granted authority, subject to any unanimous shareholder agreement, to manage or supervise the management of, the business and affairs of a corporation. In managing the corporation, the directors must govern in accordance with section 122(1) of the *CBCA*, which states that:

> Every director and officer of a corporation in exercising their powers and discharging their duties shall:
>
> (a) act honestly and in good faith with a view to the best interests of the corporation; and
>
> (b) exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances.

These two directions outline what is at the core of corporate governance law in Canada. The decisions of directors must (a) be in the best interests of the corporation, commonly referred to as the fiduciary duty, and (b), those decisions must be made using the skill and judgment of the director to a standard of a reasonably prudent person in the circumstance that the director is in, commonly referred to as the duty of care.

The goals and standards of the two duties described above have been given more concrete meaning by the courts. The *CBCA* uses the phrase "in the best interest of the corporation," but does not define which of the various stakeholders' interests should be considered, and how those interests should be balanced. Ever since Berle and Dodd debated this question over 75 years ago, the question of to whom directors owe their loyalty has been considered, with no satisfactory conclusion.[FN14] In Canada, the Supreme Court considered this question in *People's Department Stores Ltd. (1992) Inc., Re.*[FN15] The Supreme Court was considering whether the fiduciary duties of the directors should shift to looking out for the interests of creditors where a corporation is nearing insolvency and it appears that a bankruptcy proceeding is likely. The Supreme Court answered this question by stating that the duty is not owed to one particular stakeholder, but to the corporation itself.[FN16] The Supreme Court interpreted the best interests of the corporation to mean the maximization of value of the corporation, and to that end, the interests of various stakeholders may be considered:

> We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.[FN17]

The decision by the Supreme Court to interpret the duty of directors as one towards "the corporation" does not, however, answer the question of how to balance stakeholder interests when those interests might be at odds. The Supreme Court noted that "where the corporation is profitable and well capitalized and has strong prospects" the interests of shareholders and creditors may be consistent with each other.[FN18] However, in *Peoples* the corporation had entered bankruptcy proceedings, and the trustee in bankruptcy was unsatisfied with some of the business decisions that the directors made before bankruptcy which it felt were unfair and eroded the estate's

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value, sacrificing the interests of a group of creditors.[FN19] The questions that the Supreme Court had to answer in *Peoples* had to do with how to consider the interests of creditors when "the corporation approaches what has been called "the vicinity of insolvency," when the residual claims of shareholders will be nearly exhausted. [FN20] The Supreme Court dismissed any conflict by not recognizing any direct duty to the shareholders or creditors, but in maintaining that the director's fiduciary duty was only to the corporation.

The Supreme Court's consideration of whether directors' duties shift as a corporation reaches the vicinity of insolvency denies that there should be a shift in interest depending on the state of the corporation:

> The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(a) of the *CBCA*. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.[FN21]

The Supreme Court maintains that there is one clear interest, that of the corporation, that can be maintained during financial difficulties. This allows the directors to avoid considering conflicting interests, as one observer has interpreted the Supreme Court decision:

> If a fiduciary duty were owed directly to creditors, directors could, among other things, face potentially conflicting duties between two manifestly opposing parties. Even if a company is insolvent or in the vicinity of insolvency, the duties of directors to it continue unabated. If, at the same time, directors owed duties to creditors of the company, an irreconcilable conflict would arise when, for example, directors seek additional credit for the company.Dothey vigorously pursue the additional credit, thereby deepening the insolvency at the expense of creditors? Or do the directors disclose the company's financial plight, killing the company's chances of survival but minimizing the exposure of creditors. The Court's decision avoids hoisting directors on the horns of this potential conflict by clearly stating that the duty of directors never shifts and that, at least before bankruptcy, the interests of shareholders and creditors are always aligned.[FN22]

However, arguing that the interests of the corporation, including those of the shareholders and creditors are always aligned before bankruptcy may ignore some conflicts in the interests of these stakeholders. For example, consider a situation where a corporation is near insolvent with little residual value remaining for shareholders. However, there is an opportunity to 'bet the farm' in a strategy that might result in value for shareholders if successful, but leave little value for creditors in the likely event of failure. In such a situation, clearly the interests of the shareholders and creditors are not aligned.

If the duty of the directors is to the corporation, as decided by the Supreme Court, it should be asked whether that can include the value of the corporation in a liquidation or restructuring, options not mentioned by the Court in *Peoples*. Whether the interests of the corporation can be held separate from those of its stakeholders is a matter for debate and interpretation,[FN23] and given that as the example above shows there can be opposing interests amongst stakeholders, it is unclear what guidance can be derived by directors considering the interests of the corporation, as opposed to the interest of its stakeholders.

In *Stelco Inc., Re*[FN24] the Ontario Court of Appeal considered the issue of corporate governance in the context of a company that had already entered a restructuring process under the *CCAA*. The appeal arose from a decision at the Superior Court to remove two directors appointed at the request of the existing shareholders to the board during the restructuring process that had been made by Justice Farley who was supervising that process.

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[FN25] Some of the unsecured creditors of Stelco feared that the involvement of the new directors would lead to a restructuring process focused mainly on maximizing shareholder value at the expense of their interests. Justice Farley held that a supervising court can interfere with the composition of a board where there is sufficient reason to do so under the authority of section 11 of the *CCAA*. Section 11 gives the supervising judge in a *CCAA* proceeding broad powers to, where considered appropriate and on an application made under the *CCAA*, make an order.[FN26] In this case, Justice Farley was not prepared to adopt a "wait and see" approach in determining whether the directors would act in the best interests of the corporation, and used what he argued was the supervisory court's inherent jurisdiction to order that the two directors be removed from the board.[FN27]

In the unanimous appeal decision written by Justice Blair, the Ontario Court of Appeal overturned the Superior Court's ruling and reinstated the two new directors to the board.[FN28] The Court of Appeal rejected Justice Farley's conclusion that a supervising court has the power to remove directors based on its inherent jurisdiction and its discretion under section 11 of the *CCAA*. The Court of Appeal found that a court should not step into the shoes of the directors, and that the governance of the company remains with the directors and the board during the restructuring process. Justice Blair wrote that:

> Although a judge supervising a *CCAA* proceeding develops a certain "feel" for the corporate dynamics and a certain sense of direction for the restructuring, this caution is worth keeping in mind. The court is not catapulted into the shoes of the board of directors, or into the seat of the chair of the board, when acting in its supervisory role in the restructuring.[FN29]

The Court of Appeal found that section 11 only gives the supervising court a role in the process in so much as it can prevent the directors from taking certain actions as outlined in the *CCAA*. Justice Blair found that:

> What the court does under s. 11 is to establish the boundaries of the playing field and act as a referee in the process. The company's role in the restructuring, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. In the course of acting as referee, the court has great leeway, as Farley J. observed in *Lehndorff, supra*, at para 5, "to make order[s] so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors". But the s. 11 discretion is not open-ended and unfettered. Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. Moreover, the court is not entitled to usurp the role of the directors and management in conducting what are in substance *the company's* restructuring efforts.[FN30]

Although the Court of Appeal decided that there was no role in section 11 of the *CCAA* for a court to restrict the appointment of directors, the Court of Appeal did observe that under section 20 of the *CCAA* there was a way to bring in the oppression remedy and other provisions of the *CBCA*.

The combined effect of the *Peoples* and *Stelco* decisions is arguably to leave a vacuum. One way of interpreting *Peoples* is to say that the fiduciary duty concept is principally directed at self-dealing, and that absent self-dealing the directors will not be liable for breach of fiduciary duty. If so, the fiduciary duty does not inform the directors about how and why the extraordinary powers of a debtor in a reorganization are to be exercised.

The directors are also subject to the standard of care under applicable corporate law. A key task of debtor's

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counsel in a restructuring proceeding is to advise the board about the processes to follow and what management and expert reports should be received in order to be able to document that the standard of care has been met. But this is ultimately a defensive exercise engaged in for the purpose of building protections against personal claims against the directors. It does not inform the board or the debtor about what should actually be done with the debtor's restructuring powers.

As is apparent in the discussion above, the *CBCA* does not give specific direction on governance during an insolvency proceeding or restructuring. The *CBCA* is designed with the governance of solvent companies in mind, and primarily addresses the agency problems associated with the separation of ownership and control. The *CBCA*, for the most part, does not govern the relationship of companies and creditors, with the understanding that creditors are able to make contracts to protect themselves. However, where a court orders a stay under the *CCAA*, the creditors lose their contractual protection, and thus the assumptions made by the *CBCA* are not reflected in the resulting situation.

The Court of Appeal decision in *Stelco* refers to corporate law without recognizing that it was not developed with insolvency proceedings in mind. The decision then amplifies the corporate law vacuum by defining the role of the courts in a restructuring proceeding as in effect being "hands off the debtor." Its primary justification for that role is a fiction that the role of the court is to preserve the "status quo" pending a vote by the creditors on a restructuring plan.

It is inherent in the restructuring process that there be material changes in the status quo. It may be necessary for the debtor to borrow new funds secured in priority to pre-filing secured loans, to sell assets in breach of pre-filing covenants, and to terminate pre-filing contracts without paying damages for breach. These steps and many others are generally taken by the debtor before a plan is approved, often without any form of creditor approval and relying solely on the approval of the court.

In practice, a common strategy of a debtor in a restructuring proceeding is actually to try to alter the status quo before a vote is taken to such a degree that the creditors have no choice but to accept the ultimate restructuring plan as a *fait accomplis*. Canadian courts have repeatedly used their powers to assist debtors in this endeavour.

However, one can argue that the "hands off the debtor" approach is still correct even if the status quo rationale for it is wrong. A restructuring can involve many practical business decisions that are beyond the expertise of the court. It can be cogently argued as a result that it would not be appropriate for a court to second guess management. One consequence of that view is that it renders the court approval process largely meaningless. And what then are the checks and balances on the debtor?

Finally, the uncertainties in the law have been compounded by the fact that the result in *Stelco* has in substance been overturned by the *Reform Act*. The *Reform Act* gives the courts the express power to remove directors during reorganization proceedings in certain circumstances. What does that do to the rationale of the *Stelco* decision?

3. — CCAA Monitor

One possible counterweight to the powers given to the debtor under the Canadian system is provided by the requirement in *CCAA* proceedings to have a "monitor," and in *BIA* proceedings to have a trustee.

The requirement for an appointment by the court of a monitor in *CCAA* proceedings is a relatively new develop-

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ment. Prior to 1997, the *CCAA* did not require the appointment of a monitor. However, in the years prior to that time a practice developed of having the court appoint an accounting firm to perform an officially sanctioned role in the *CCAA* proceedings. At a time when there was relatively more suspicion about the restructuring process, their role was often analogized to that of an interim receiver appointed under section 46 of the *BIA* to monitor the debtor's conduct while a disputed bankruptcy petition is outstanding. Indeed, in *CCAA* cases in the 1980s the monitors were often called "Interim Receivers". (See for example, *Re United Co-Operatives of Ontario*[FN31] and *Northland Properties Ltd., Re.*[FN32]) They could be selected and appointed directly or indirectly at the instigation of key creditors as a watchdog to observe the conduct of management and the operation of the business while a plan was being formulated. Over time, wise debtors co-opted the process by asking the court to appoint "their" accounting firm to forestall the appointment of a different firm selected by the creditors.

One practical issue that led to the judicial appointment of accounting firms was the protection of fees. When creditors instigated the appointment, they wanted the fees paid for by the debtor, and when the debtor instigated the appointment, the accountants wanted security of payment. After some judicial doubt, it was concluded that the court had the jurisdiction to protect the fees on the basis that once appointed, the accounting firm was either an officer or an agent of the court.[FN33]

During the development of the 1997 round of insolvency law reform, the Bankruptcy and Insolvency Advisory Committee ("BIAC") task force studying the *CCAA* recommended that the appointment of a monitor be made mandatory so as to "give creditors in *CCAA* applications the same protection of a professional and impartial "watchdog", as is provided to creditors in *BIA* reorganizations."[FN34] When the *CCAA* was amended in 1997 to require the appointment of a monitor, the statutory language used to describe the monitor's role was consistent with the watchdog concept. The basic purpose of the appointment was described as being "to monitor the business and financial affairs of the company while the [initial order] remains in effect."[FN35] The monitor was given express access to the debtor's books, records and property for the purpose, and was required to report "on the state of the company's business and financial affairs"[FN36] if there was a material adverse change in the debtor's projected cash-flow or financial circumstances and also prior to creditor meetings. There were no other express powers or duties.

The court was given the power to order the monitor "to carry out such other functions in relation to the company as the court may direct."[FN37] This catch all provision has been used to adjust the role of the monitor on a case-by-case basis. It is now typical for an initial order under the *CCAA* to have numerous provisions dealing with the powers and duties of the monitor.

In most *CCAA* cases, the monitor plays a broader role than watchdog. In practice, the monitor plays an expanded role that depends firstly on management and secondly, where there are key creditors or groups of creditors, on the relationship between management and those key creditors. In practice, monitors are hired by the debtor and in substance often act as an advisor to the debtor, albeit with special responsibilities.

The role of the monitor is further confused by the role the monitor plays in court during proceedings under the *CCAA*. Because the monitor is appointed by the court, early on the courts concluded that the monitor was either an agent of the court[FN38] or an officer of the court.[FN39] The courts have also concluded that the monitor has an "obligation to act independently and to consider the interest of the petitioners and its creditors."[FN40] In one pre-1997 case, the Court commented:

> It is essential for the court to ensure that neither the shareholders nor the creditors have any influence over

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the monitor. As an agent of the court, the monitor must not be in a "conflict of interest" situation. The monitor's sole responsibility is to the court.[FN41]

The fact that the monitor has been adviser to the debtor before the filing has not been considered problematic. [FN42] However, disclosure at the time of the appointment is the correct practice and may be required under applicable professional rules.[FN43]

Justice Farley commented in one case that the monitor "recognizes its role is to be neutral and to act in the best interests of all concerned."[FN44] In another, he noted that there was no jurisprudence to support an argument that a monitor represents the interest of the creditors in the same way as a trustee in bankruptcy, receiver or liquidator.[FN45]

Some courts have viewed the monitor as a competent and independent expert providing advice to the court on the merits of the reorganization plan,[FN46] and another stated that "[t]he monitor must be an agent of the court, it must assist the court and it must be independent of any of the parties."[FN47]

This view of the monitor has a number of consequences. First, the monitor can provide evidence by way of report rather than affidavit, and is generally not subject to cross-examination. The courts understandably place great trust and confidence in the information provided by the monitor, and are unreceptive to criticisms or conflicting evidence.

As a result, where the debtor and the monitor are in agreement, debtor's counsel put in little or no evidence and instead may rely on the monitor's reports. In practical terms, this makes it very difficult for stakeholders to challenge the debtor's position.

Second, in their reports monitors now routinely go beyond simply providing information. They will express views and make recommendations to the court concerning matters before the court. Once again, it is difficult for stakeholders to challenge the monitor's views as an independent expert and officer of the court.

These factors have become increasingly significant as the shape of *CCAA* proceedings has changed. It used to be that the courts provided a standstill while the principals negotiated. The major commercial transactions were implemented through the plan of arrangement and were therefore subject to prior creditor class approval. In effect, the *CCAA* operated as a mandatory ADR process that encouraged resolution of business issues through negotiations between the parties whose interests were at stake.

But now major commercial transactions are implemented on an interim basis during the course of *CCAA* proceedings before a plan is filed, with court approval being substituted for creditor approval. This can now extend to transactions as fundamental as a sale of all or substantially all of the business or assets of the debtor.[FN48]

On application for approval of these transactions, invariably the monitor will file a report and make a recommendation as to whether the proposed transaction should be approved by the court. Almost as invariably, the courts will defer to the monitor's views. Accordingly, in substance these transactions are really subject to monitor approval. As a result the monitor's judgment has replaced the judgment of the court or the creditors.

Monitors can use the threat of withholding their approval to negotiate with the debtor. The debtor knows that, as a practical matter, it will be difficult to obtain court approval for a major transaction without having the monitor's prior approval. So the monitors can and do constructively influence the debtor's conduct. It can therefore be

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the reality that the real negotiations in the proceedings take place in secret between the monitor and management for the debtor. This has the odd result that one of the key negotiating parties has no direct economic stake in the outcome of the case.

It was the view of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform (the "JTF") on Independence Issues and the Role of the Monitor, that the monitor must be the "ears and eyes" of the court and that it was critical that the monitor should not be put in a position where it acts as an advocate for the applicants. In its June 30, 2005 Supplemental Report (the "JTF Supplemental Report") to Industry Canada, the JTF stated that:

> While it is understood and accepted that in reporting on factual matters, a Monitor will necessarily put forward views — sometimes strong views — on business related matters affecting the applicants, a Monitor should not file a factum or take positions on the legal aspects of any contested issues in the *CCAA* proceeding. Instead, advocacy of those legal matters should be left to the applicants and any stakeholders who are challenging a position being taken by the applicants.[FN49]

Based on that principle, the JTF recommended to Industry Canada that the legislation should:

> (a) Provide that the party with the primary obligation to advance a position and adduce evidence before the court should be the applicant and not the Monitor.
>
> (b) Provide that the Monitor, unless otherwise required by the court, should avoid taking any legal positions or filing a factum regarding contested legal disputes among the parties.
>
> (c) Provide for an amendment to the *CCAA* section 11.7 to stipulate that the primary roles of the monitor are (a) to monitor the activities of the debtor for the benefit of all interested parties and the court, and (b) to work impartially with the debtor and all interested parties to facilitate the restructuring process.[FN50]

None of these recommendations were adopted in the *Reform Act*.

4. — Debtor's Counsel

The professionals retained by the debtor in *CCAA* proceedings, such as counsel for the debtor, play a special role and have a significant impact on the conduct of the proceedings.

Under the U.S. *Bankruptcy Code*, in order for a professional to be retained by the debtor, the professional must submit an application for employment to the court for approval. The statement must describe all interests the attorney has in the case and reveal all relationships the attorney has with the interested parties. The judge then examines the statement and either approves the attorney's retention or disapproves and disqualifies the attorney. The attorney must be "disinterested" and must not hold an "adverse interest" to the estate.[FN51]

Under the *Bankruptcy Code*[FN52] to be "disinterested" an attorney must not be a creditor, equity security holder, an insider of the debtor, must not be or have been within two years of the bankruptcy filing, a director, or employee of the debtor, and must not have an interest materially adverse to the interest of the estate, any class of creditors, or equity security holders.

One practical consequence of these rules is that Chapter 11 debtors generally hire specialized bankruptcy counsel to act on their behalf. This creates a check and balance on management that does exist in the Canadian sys-

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tem where typically the debtor's primary pre-filing corporate counsel acts as bankruptcy counsel. Until recently there were no rules in Canada's insolvency legislation that attempted to ensure the independence of professionals retained by the debtor, but who act as court officers (such as Monitors) or advisors to court officers.

The JTF Supplemental Report also included recommendations concerning the engagement of certain "specified professionals" in *CCAA* proceedings designed to address the independence and conflict of interest issues. The JTF was of the view that it is important for the professionals to have a high degree of independence and have the proper professional qualifications.

The JTF recommended that the appointment and retention of a proposed "specified professional" should be confirmed by the court at a confirmation hearing made on notice to all creditors. The JTF defined "specified professionals" to mean professionals retained on behalf of the applicants, as or by an officer of the court (*e.g.*, representative counsel and advisors to official creditor committees), to provide specialized services relating to the proceedings and who are being paid by the estate. Such specified professionals include lawyers, accountants, monitors, chief restructuring officers, trustees, receivers, investment banks, actuaries, and liquidators.

In its Report, the JTF provided the following helpful commentary on the confirmation process:

> In determining whether to confirm the appointment of a specified professional, the onus would be on the applicant to satisfy the court that the professional has the appropriate qualifications and can provide independent advice to the party of interest, taking into consideration whether the professional can provide the engagement party with unfettered advice free from any conflicts of influence and whether a professional acting as a court officer can act in an impartial manner with the ability to deal with the rights of all interested parties in a fair and evenhanded manner. For example, this would generally preclude a member of historic management acting as a chief restructuring officer of the debtor.
>
> In order to assist the court, the proposed specified professionals would be under a positive duty to disclose certain information to the court, including (i) any work they have done for the applicants within the two (2) years prior to the filing, except as specifically relates to planning for a filing, (ii) any work done on behalf of any interested party specifically relating to the applicants within the two (2) years prior to the filing (other work done for interested parties is not necessary to disclose), (iii) any work performed on behalf of any parent of any applicant in the two (2) years prior to filing, (iv) any work done on behalf of any subsidiary or sister company of the applicants in the two (2) years prior to the filing and (v) any other matter that might constitute a direct material conflict.
>
> An actual conflict of interest (that includes both any existing conflict or any likely conflict or potentially likely to arise in the course of the administration) should disqualify a specified professional. A perceived conflict of interest should be considered a disqualifying fact only if severe enough to jeopardise the likelihood of the proceedings coming to a reasonable and efficient conclusion or if the perceived conflict of interest is severe enough to place the professional in a position where he cannot work in harmony with the party he is to represent.[FN53]

The JTF also made recommendations for factors that would not specifically disqualify the professional from acting, but that should be seriously considered by the court. A recommendation was also made that the court should have the power to remove specified professionals at any time. Under the JTF recommendations, the court would have the discretion to sanction payments of fees for services performed by a specified professional in good faith prior to the determination by the court not to confirm the professionals' appointment.

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None of the recommendations of the JTF concerning the appointment, retention, and confirmation of professionals found their way into the *Reform Act*. However, the Act does include provisions that attempt to address some issues of independence, requirements, and oversight. The *Reform Act* strengthens the independence of monitors by requiring a monitor to be a trustee within the meaning of the *Bankruptcy and Insolvency Act*, and also requires that during the past two years the monitor did not have connections to the insolvent company, such as acting as a director, officer, or auditor of the company.[FN54] In addition, Bill C-55 gives the Superintendent of Bankruptcy the right to apply to the court to review the appointment or conduct of a monitor and intervene as if it were a party "in any matter or proceeding in court relating to the appointment or conduct of a monitor."[FN55]

5. — Creditor Voting and Classes

A key check and balance on the debtor remains the requirement that the creditors approve a restructuring plan if the debtor itself is to remain the owner of the restructured business. The right of creditors to vote to approve or reject a proposed plan of compromise or arrangement is a foundational element of the *CCAA*. In that sense, a *CCAA* restructuring can be, at its core, a fundamentally democratic process.

However, in order to give effect to the democratic ideal and ensure a fair and equitable result, it is necessary to consider and address the potential tyrannies of both majority and minority. The statute seeks to address this, in part, by the division of the creditors into classes. Only the members of the classes that approve the plan in accordance with the double majority test prescribed by the Act are bound by the plan.[FN56]

Because a different state of facts exists with respect to different creditors which may affect their minds and judgments differently, creditors must be separated into different classes, each of which is comprised of those with common interests.[FN57] If a class is too broadly defined, a majority may be in a position to approve a plan that is coercive and/or confiscatory of the legal rights voluntarily granted by the applicant to a minority of its creditors.[FN58] Fragmentation of the creditor group into too many classes may place the success of the plan at risk as members of each class are incentivized to condition their support for the plan on a better deal for their individual class, even at the expense of the odds of a successful restructuring for the benefit of all classes. As a result, the composition of classes under a plan can have a fundamental effect on the voting outcome.

The primary responsibility for making the classification is on the debtor.[FN59] As the party with the greatest perceived stake in a successful reorganization, the debtor benefits from the broadest possible classification of creditors resulting in the fewest number of classes. Accordingly, a question becomes, what legal parameters or guidelines should be applied by the court in order to strike an appropriate balance between, on the one hand, facilitating a successful restructuring for the collective benefit, and, on the other, respect for the unique positions of dissenting creditors.

Prior to the enactment of the amendments to the *CCAA* under the *Reform Act*, the *CCAA* itself did not provide the courts with express guidance as to how as to how to resolve that tension. The courts were left to fill the legislative vacuum with judicially established tests designed to group together creditors with common interests while at the same time seeking to avoid a fragmentation of creditors that would inevitably defeat the plan. The application of the non-fragmentation principal has operated as an exception to the general rule that a court should not comment on a proposed plan prior to approval by the creditors.[FN60]

The *Reform Act* expressly refers to what has become known as the commonality of interest test and sets out the following four factors to be taken into account by the court when determining whether the interests of creditors are sufficiently aligned to justify inclusion in a common class.

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(a) the nature of the debts, liabilities or obligations giving rise to their claims;

(b) the nature and rank of any security in respect of their claims;

(c) the remedies available to the creditors in the absence of the compromise or arrangement being sanctioned, and the extent to which the creditors would recover their claims by exercising those remedies; and

(d) any further criteria, consistent with those set out in paragraphs (a) to (c), that are prescribed.[FN61]

The *Reform Act* also codifies the practice of seeking court approval of the applicant's proposed classification of creditors prior to the holding of the meeting of creditors.[FN62]

To date, the Canadian courts have established the following as principles to be considered when making an assessment as to commonality of interest:

(a) Commonality of interest should be viewed on the basis of a non-fragmentation test, not on an identity of interest test.

(b) The interests to be considered are the legal interests the creditor holds *qua* creditor in relationship to the debtor company, prior to and under the plan as well as on liquidation.

(c) The commonality of these interests are to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate reorganizations if at all possible.

(d) In placing a broad and purposive interpretation on the CCAA, the court should be careful to resist classification approaches which would potentially jeopardize potentially viable plans.

(e) Absent bad faith, the motivations of the creditors to approve or disapprove are irrelevant.

(f) The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar interest.[FN63]

The overriding concern that fragmenting the creditors into too many classes may doom the vote on a plan can be discerned in each of the above factors and throughout the jurisprudence on creditor classification. Courts have held that the classification must not be so fine that it renders it impossible to get a plan approved and that a class "must be confined to those persons whose rights are not so dissimilar as to make it *impossible* for them to consult together with a view to their common interests" [emphasis added].[FN64] The paramount importance placed on the success of the plan can also be seen in the decision of the Ontario Court of Appeal in *Re Stelco Inc.*:

Finally, to hold the classification and voting process hostage to the vagaries of a potentially infinite variety of disputes as between already disgruntled creditors who have been caught in the maelstrom of a CCAA restructuring, runs the risk of hobbling that process unduly. It could lead to the very type of fragmentation and multiplicity of discrete classes or sub-classes of classes that judges and legal writers have warned might well defeat the purpose of the Act.

In the end, it is important to remember that classification of creditors, like most other things pertaining to the *CCAA*, must be crafted with the underlying purpose of the CCAA in mind, namely facilitation of the reorganization of an insolvent company through the negotiation and approval of a plan of compromise or

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> arrangement between the debtor company and its creditors, so that the debtor company can continue to carry on its business to the benefit of all concerned. As Paperny J. noted in *Canadian Airlines Corp. Re*, "the Court should be careful to resist classification approaches that would potentially jeopardize viable plans."[FN65]

Unfortunately, little is said about the characteristics or qualities of a fair plan or the legitimate expectations of minority creditors. As a result, courts have tended to reject applications by creditors for the establishment of additional classes.

For example, in *Sklar-Peppler Furniture Corp.*,[FN66] the court rejected an argument by a group of landlords who argued that their interests were sufficiently distinct from those of other unsecured creditors to warrant a separate class. The court held that it would be improper to create a special class simply for the benefit of an opposing creditor that would give that creditor the potential to exercise an unwarranted degree of power, but it did not address the distinction between warranted and unwarranted power. Because the classification of creditors on the basis of identity of interests, as suggested by the landlords, would in some instances result in a multiplicity of classes, which would make any reorganization difficult, if not impossible, neither the realty lessors nor equipment lessors were granted a separate class.

Courts have also expressed concern about the confiscation of legal rights.[FN67] However, the jurisprudence reflects a reluctance to find a lack of commonality of interest to justify inclusion of creditors in a common class. While it has been held that a bank which has a first claim on accounts receivable and inventory is entitled to be put in a different class from a creditor holding a second claim on those same assets,[FN68] it has also been held that it does not automatically follow that those who have different commercial interests, such as those who hold security on "quick" assets, are necessarily in conflict with those who hold security on hard or fixed assets. [FN69]

In the result, it appears that the key consideration that informs most classification decisions by the courts is minimizing the risk of the plan not being approved by minimizing the number of creditor classes.

6. — Creditors Committees

An important check and balance in the U.S. bankruptcy system is the mandatory formation of at least one official creditors' committee with professional advisors funded by the estate. In Canada there has been considerable hostility towards the concept of official committees, although it is not unusual in larger cases for the debtor to voluntarily fund one or more ad hoc committees.

The Canadian hostility to official committees is rooted in part in the perception that they tend to make restructuring proceedings materially longer and more expensive without adding value to the process. The *Reform Act* does not directly contemplate the formation of creditors' committees, but arguably it expressly empowers the court to order that the professional costs of a committee be funded by the debtor.

7. — Court Sanction of a Plan

A final check and balance in the system is the requirement that the court sanction a plan of reorganization after it has been approved by the creditors. It is helpful to consider the tests for plan sanction in the context of the courts' overall approach to the *CCAA*.

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The *CCAA* is by no means a complete codification of the legal regime under which parties operate in a *CCAA* proceeding. It is more akin to a set of broad guidelines. One reason given for this is that the courts must have the flexibility to address issues as they arise in the "real-time" context of restructurings and should not be bound by an extensive code of rules which would fetter their discretion.

The courts have held that the *CCAA's* objective is to enable a debtor company to carry on its business in a manner that is designed to cause the least possible harm to itself, its creditors, its employees and former employees and the communities in which it carries on business,[FN70] but over the years there has been a shift to favour the desire for a successful restructuring rather than protect the interests of creditors and other stakeholders. Part of the reason for this shift has been the argument that Parliament intended for this to be the role of the courts in *CCAA* proceedings. The formal title of the *CCAA* is "An Act to facilitate compromises and arrangements between companies and their creditors" and many counsel have used the term "facilitative" to argue that the court has not only the power, but the obligation, to ensure the successful restructuring of a debtor, despite the negative impact this may have on some of the debtor's stakeholders. As a result, courts have consistently held that the *CCAA*, as remedial legislation, should be given a large and liberal interpretation so as to encourage and facilitate successful restructurings whenever possible.[FN71]

In facilitating the achievement of the *CCAA's* objectives, courts have relied on their inherent or implied jurisdiction or alternatively, on their broad discretion under section 11 of the *CCAA*, as the source of judicial power to "fill in the gaps"[FN72] or "put flesh on the bones" of the statute.[FN73] This has led not only to an expansive view of the courts' ability to work around the few legal tests that are codified in the *CCAA*, but to grant a broad range of relief that is not provided for.

Once the creditors have approved the plan, a hearing is held for the court to sanction it. There is no explicit test set out in the *CCAA* for the sanctioning of a plan, but the courts have developed a test which provides that a plan will be sanctioned if (a) there has been compliance with all statutory requirements and orders, (b) nothing has been done or purported to be done that is not authorized by the *CCAA*, and (c) the plan is "fair, reasonable and equitable."[FN74]

As a practical matter, in most cases it is the third branch of the test that is in issue if there is a serious contest over the sanctioning of a *CCAA* plan. In determining whether a plan is fair and reasonable, the court will take into consideration the impact of the plan upon all the interested parties including creditors and shareholders. Despite the discretion afforded to the court in sanctioning the final plan, case law has generally established that where the required majorities have approved the plan, the court should hesitate to substitute its view of what is fair and reasonable for that of those affected by the plan. In *Olympia & York Developments Ltd. v. Royal Trust Co.*, it was stated that an important measure of whether a plan is fair and reasonable is the parties' approval of the plan and the degree to which the approval has been given.[FN75] In *Repap British Columbia Inc., Re*, the British Columbia Supreme Court even went so far as to state that even if the court is unable to find that the plan is fair and reasonable, if a large majority of creditors have approved it, the court may still sanction it.[FN76] What is fair and reasonable does not mean equal to all,[FN77] the plan need only achieve a compromise which is fair, reasonable, and feasible.[FN78]

In light of this, the burden of a creditor requesting that the court not sanction a plan that has been approved by the majority of creditors is very heavy.

8. — Conclusion

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Over the last 25 years or so the Canadian business insolvency system has moved away from focusing on sale proceedings conducted principally for the direct benefit of creditors. It now focuses on reorganization proceedings controlled by the debtor. There are clear potential advantages to this shift.

In order for debtors to be able to reorganize, they have to have extraordinary powers or tools that would not be available to them outside of an insolvency proceeding. In Canada, many of these extraordinary powers or tools were first authorized by the exercise of judicial discretion rather than as a result of legislative reform. In a sense, the *Reform Act* completes the process of empowering debtors by expressly conferring the extraordinary tools developed in the courts.

However, this shift has created a vacuum. The *Reform Act* contains no direct guidance on the question of how the debtor should decide to use its extraordinary powers. As a result, by default the courts look to applicable corporate law. However, Canada's corporate laws were developed for solvent entities acting without the extraordinary powers that are now available in insolvency proceedings. The corporate laws do not in substance provide any real guidance about how and why the extraordinary tools available to a debtor in insolvency should be used.

The courts have shied away from policing the exercise of those extraordinary powers and have proactively limited the role of the creditors in restructuring proceedings, fearing that empowering the creditors would tend to put the "success" of the restructuring proceedings at risk.

Court appointed monitors have influence over debtors, but monitors are hired by the debtor and have no direct economic stake in the process. There are material limits upon what can be fairly expected of monitors given the underlying foundations of their role.

The cumulative effect of these various factors is that Canada now has a system that encourages reorganizations by the debtor but has few meaningful checks and balances. It is hard to see when a court should say no to a debtor if it has the jurisdiction to say yes.

During the statutory reform process suggestions for creating various checks and balances in the system were advanced but not adopted.

In fact, the *Reform Act* itself provides little guidance about how the debtor is to use its new powers.

It is clear that the implications of this result have not been weighed in the balance. Unless one believes that any "restructuring" is inherently better than the alternatives, there are good reasons to be concerned about these implications.

FN1. Andrew J.F. Kent and Wael Rostom are partners, and Adam Maerov and Tushara Weerasooriya are associates, in the Corporate Restructuring Group at McMillan LLP. The authors would like to acknowledge the excellent contributions of Brett Harrison, partner and Toby Whitfield, articling student, at McMillan LLP.

FN2. S.C. 2005, c. 47 [*Statute* c. 47].

FN3. Bill C-12 was enacted as: *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada*, 2005, S.C. 2007, c. 36.

FN4. Consider, for example, the advice of the president of the English board of trade to the English House of

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Commons in connection with the debates over the *Bankruptcy Act*, 1883:

> . . . to keep in mind two main, and, at the same time, distinct objects of any good Bankruptcy Law. Those were, firstly, in the honest administration of bankrupt estates, with a view to the fair and speedy distribution of the assets among the creditors, whose property they were; and, in the second place their object should be, following the idea that prevention was better than cure, to do something to improve the general tone of commercial morality, to promote honest trading, and to lessen the number of failures.

See Richard. H. McLaren, *Canadian Commercial Reorganization*, loose leaf vol.1 (Aurora: Canada Law Books, 1994) at 1-20.

FN5. For example, while the ability to make a proposal to ones creditors has been a part of Canadian bankruptcy law since the introduction of the *Bankruptcy Act* of 1919, it was only after the 1949 amendments that a debtor could make a proposal to its creditors without first making an assignment or having a receiving order made against it. Furthermore, it was not until the major overhaul of the bankruptcy regime in 1992 that a debtor was given the benefit of a stay of proceedings against secured creditors on the filing of a notice of intention. See McLaren, *ibid.*, at 1-5 to 1-6.

FN6. R.S.C. 1985, c. C-36 [*CCAA*].

FN7. Indeed, at the time of its enactment, the *CCAA* was meant to be used only by companies with secured indebtedness on the understanding that debenture holders (represented by a debenture trustee) had sufficient leverage to affect a fair compromise with the debtor, without the necessity for government regulation of the process. The rise in the use of the *CCAA* by companies with only unsecured debt and the recognition that unsecured creditors did not have sufficient power to bargain with the debtor almost led to the Act's repeal in 1938. See McLaren, *supra*, n. 3 at 1-14.

FN8. Lloyd W. Houlden & Geoffry B. Morawetz, *The 2007 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 2007) N§1, citing *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 80 C.B.R. (N.S.) 98, 1990 CarswellBC 425 (B.C. S.C.) and *Milner Greenhouses Ltd. v. Saskatchewan*, 2004 CarswellSask 280, [2004] S.J. No. 264, 2004 SKQB 160, 50 C.B.R. (4th) 214, [2004] 9 W.W.R. 310, 48 B.L.R. (3d) 276, 252 Sask. R. 42 (Sask. Q.B.).

FN9. McLaren, *supra*, n. 3 at 1-20.

FN10. See Thomas H. Jackson, "Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain" (1982) 91 Yale L.J. 857; Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, MA: Harvard University Press, 1986).

FN11. Elizabeth Warren, "Bankruptcy Policy" (1987) 54 U. Chicago L. Rev. 75; *cf.* Douglas Baird, "Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Professor Warren" (1987) 54 U. Chicago L. Rev. 815.

FN12. See Industry Canada, "Questions and Answers on the Amendments to the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangements Act*" (Created: June 1, 2005). Available online: <http://www.ic.gc.ca/epic/site/cilp-pdci.nsf/en/cl00782e.html>.

FN13. R.S.C. 1985, c. C-44 [*CBCA*].

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FN14. E.M. Dodd, "For Whom Are Corporate Managers Trustees?" (1932) 45 Harv. L. Rev. 1049; A.A. Berle, "For Whom Corporate Managers *Are* Trustees" (1933) 45 Harv. L. Rev. 1365.

FN15. 2004 CarswellQue 2862, 2004 CarswellQue 2863, [2004] S.C.J. No. 64, REJB 2004-72160, 326 N.R. 267 (Eng.), 326 N.R. 267 (Fr.), 4 C.B.R. (5th) 215, [2004] 3 S.C.R. 461, 2004 SCC 68, 244 D.L.R. (4th) 564, 49 B.L.R. (3d) 165 (S.C.C.) [*Peoples*].

FN16. *Ibid.*

FN17. *Ibid.*, at para. 42.

FN18. *Ibid.*, at para. 44.

FN19. *Ibid.*, at para. 23.

FN20. *Ibid.*, at para. 45.

FN21. *Ibid.*, at para. 43.

FN22. Wayne D. Gray, "A Solicitor's Perspective on *Peoples v. Wise*" (2005) 41 Can. Bus. L.J. 184 at 188.

FN23. Ian B. Lee, "Peoples Department Stores v. Wise and the 'best interests of the corporation'" (2005) 41 Can. Bus. L.J. 212.

FN24. (2005), [2005] O.J. No. 1171, 2005 CarswellOnt 1188, 253 D.L.R. (4th) 109, 75 O.R. (3d) 5, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 196 O.A.C. 142 (Ont. C.A.).

FN25. (2005), 2005 CarswellOnt 742, [2005] O.J. No. 729, 7 C.B.R. (5th) 307 (Ont. S.C.J. [Commercial List]); additional reasons at (2005), [2005] O.J. No. 730, 2005 CarswellOnt 743, 7 C.B.R. (5th) 310 (Ont. S.C.J. [Commercial List]); reversed (2005), [2005] O.J. No. 1171, 2005 CarswellOnt 1188, 253 D.L.R. (4th) 109, 75 O.R. (3d) 5, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 196 O.A.C. 142 (Ont. C.A.).

FN26. *CCAA*, *supra*, n. 5, s. 11(1).

FN27. *Supra*, n. 24, at paras. 23-24.

FN28. *Supra*, n. 24.

FN29. *Supra*, n. 23 at para. 68 [citations omitted].

FN30. *Ibid.*, at para. 44.

FN31. (August 1984), unreported.

FN32. (1988), 1988 CarswellBC 558, 73 C.B.R. (N.S.) 175 (B.C. S.C.); affirmed [1989] B.C.J. No. 63, 1989 CarswellBC 334, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (B.C. C.A.).

FN33. *Starcom International Optics Corp., Re* (1998), 1998 CarswellBC 477, [1998] B.C.J. No. 506, 3 C.B.R. (4th) 177 (B.C. S.C. [In Chambers]); *Fairview Industries Ltd., Re* (1991), 297 A.P.R. 12, 109 N.S.R. (2d) 12, 11 C.B.R. (3d) 43, 1991 CarswellNS 35 (N.S. T.D.) [*Fairview*]; *Canadian Asbestos Services Ltd. v. Bank of*

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Montreal, 1992 CarswellOnt 936, [1992] O.J. No. 2320, 16 C.B.R. (3d) 114, [1992] G.S.T.C. 15, 11 O.R. (3d) 353, 5 T.C.T. 4328, 93 D.T.C. 5001, 5 C.L.R. (2d) 54, [1993] 1 C.T.C. 48 (Ont. Gen. Div.); additional reasons at 1993 CarswellOnt 816, 13 O.R. (3d) 291, 10 C.L.R. (2d) 204, [1993] G.S.T.C. 23, 1 G.T.C. 6169 (Ont. Gen. Div.).

FN34. Report of the Task Force on the CCAA to the Bankruptcy and Insolvency Advisory Committee Working Group on Commercial Reorganizations, Bankruptcies and Receiverships, 1994 at 3.

FN35. *CCAA*, *supra*, n. 5, s. 11.7(1).

FN36. *Ibid.*, s. 11.7(3)(b).

FN37. *Ibid.*, s. 11.7(3)(d).

FN38. *Fairview*, *supra*, n. 32, Glube C.J.T.D. at para. 75. See also *Siscoe & Savoie v. Royal Bank* (1994), 404 A.P.R. 42, 157 N.B.R. (2d) 42, 29 C.B.R. (3d) 1, 1994 CarswellNB 14 (N.B. C.A.); leave to appeal refused (1995), 32 C.B.R. (3d) 179n (S.C.C.) at para. 28.

FN39. *United Used Auto & Truck Parts Ltd., Re* (1999), 1999 CarswellBC 2673, [1999] B.C.J. No. 2754, 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); affirmed 2000 CarswellBC 414, [2000] B.C.J. No. 409, 2000 BCCA 146, 135 B.C.A.C. 96, 221 W.A.C. 96, 73 B.C.L.R. (3d) 236, 16 C.B.R. (4th) 141, [2000] 5 W.W.R. 178 (B.C. C.A.); leave to appeal allowed (2000), 2000 CarswellBC 2132, 2000 CarswellBC 2133, [2000] S.C.C.A. No. 142, 261 N.R. 196 (note), 149 B.C.A.C. 160 (note), 244 W.A.C. 160 (note) (S.C.C.) at para. 20 [*United*].

FN40. *Ibid.*

FN41. *Stokes Building Supplies Ltd., Re* (1992), 1992 CarswellNfld 20, 318 A.P.R. 114, 100 Nfld. & P.E.I.R. 114, 13 C.B.R. (3d) 10 (Nfld. T.D.) at para. 15.

FN42. *United*, *supra*, n. 38.

FN43. Rules of Professional Conduct and Interpretation, Canadian Association of Insolvency and Restructuring Professionals, "Interpretations to the Rules," Rule 6, online: <http://www.cairp.ca/english/regulation_members/rules_of_conduct.asp>.

FN44. *Royal Oak Mines Inc. Re* (1999), [1999] O.J. No. 1369, 11 C.B.R. (4th) 122, 1999 CarswellOnt 1068 (Ont. Gen. Div. [Commercial List]) at para. 6.

FN45. *PSINet Ltd., Re* (2002), [2002] O.J. No. 271, 3 P.P.S.A.C. (3d) 208, 30 C.B.R. (4th) 226, 2002 CarswellOnt 211 (Ont. S.C.J. [Commercial List]); affirmed (2002), 32 C.B.R. (4th) 102, 2002 CarswellOnt 619 (Ont. C.A.) at para. 12.

FN46. *Canadian Imperial Bank of Commerce v. Quintette Coal Ltd.* (1991), 1991 CarswellBC 457, 53 B.C.L.R. (2d) 34, 1 C.B.R. (3d) 253 (B.C. S.C.).

FN47. *Fairview*, *supra*, n. 32 at para. 75.

FN48. *Consumers Packaging Inc., Re* (2001), [2001] O.J. No. 3736, 27 C.B.R. (4th) 194, 2001 CarswellOnt 3331 (Ont. S.C.J. [Commercial List]); leave to appeal refused (2001), [2001] O.J. No. 3908, 12 C.P.C. (5th) 208,

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2001 CarswellOnt 3482, 27 C.B.R. (4th) 197, 150 O.A.C. 384 (Ont. C.A.).

FN49. The Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform, "Supplemental Report" (June 30, 2005), Schedule S, "Supplemental Reform Proposals With Commentary", at commentary to proposal 18.

FN50. *Ibid.*, proposals 17-19.

FN51. *Bankruptcy Code*, 11 U.S.C. § 11327.

FN52. *Ibid.*, § 11101(14).

FN53. *Supra*, n. 48.

FN54. *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 129.

FN55. *Supra*, n. 1, s. 27.

FN56. A plan may be sanctioned by the Court where a majority in number representing two-thirds in value of the voting creditors, or class of voting creditors, approve the plan; *CCAA*, *supra*, n. 5, s. 6.

FN57. *Sovereign Life Assurance Co. v. Dodd* (1892), [1891-94] All E.R. Rep. 246, [1892] 2 Q.B. 573 (Eng. C.A.) [*Sovereign Life*].

FN58. *Alabama, New Orleans, Texas & Pacific Junction Railway, Re* (1890), [1891] 1 Ch. 213, 2 Megones Companies Act Cas 377, 7 T.L.R. 171, 64 L.T. 127, [1886-90] All E.R. Rep. Ext. 1143, 60 L.J. Ch. 221 (Eng. C.A.).

FN59. *Hellenic & General Trust Ltd., Re* (1975), [1976] 1 W.L.R. 123, 119 Sol. Jo. 845, [1975] 3 All E.R. 382 (Eng. Ch. Div.).

FN60. *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312, 1991 CarswellOnt 220 (Ont. Gen. Div.).

FN61. *Supra*, n. 2, s. 71 [amending *Statute c. 47*, s. 131 and *CCAA*, s. 22(2)].

FN62. *Supra*, n. 2, s. 71 [amending *Statute c. 47*, s. 131 and *CCAA*, s. 22(1)].

FN63. *Canadian Airlines Corp., Re*, 2000 CarswellAlta 503, [2000] A.J. No. 610, 80 Alta. L.R. (3d) 213, 2000 ABCA 149, 19 C.B.R. (4th) 33, 261 A.R. 120, 225 W.A.C. 120 (Alta. C.A. [In Chambers]); *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 307, 11 B.L.R. (4th) 185, 261 D.L.R. (4th) 368, 78 O.R. (3d) 241, [2005] O.J. No. 4883, 204 O.A.C. 205, 2005 CarswellOnt 6818 (Ont. C.A.), at paras. 23-27; additional reasons at (2006), 2006 CarswellOnt 5194 (Ont. C.A.).

FN64. *Sovereign Life*, *supra*, n. 56 at 583 [Q.B.].

FN65. *Stelco Inc., Re* (2005), *supra*, n. 62 at paras. 35-36.

FN66. *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*, *supra*, n. 59.

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FN67. *Stelco Inc., Re* (2005), *supra*, n. 62; *Campeau Corp., Re* (1992), [1992] O.J. No. 237, 1992 CarswellOnt 161, 10 C.B.R. (3d) 104 (Ont. Gen. Div.); *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), (1990), 1990 CarswellOnt 139, 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey*) 1 O.R. (3d) 289, (sub nom. *Elan Corp. v. Comiskey*) 41 O.A.C. 282 (Ont. C.A.).

FN68. *Campeau Corp., Re, ibid.*

FN69. *Fairview Industries Ltd., Re* (1991), 1991 CarswellNS 36, 109 N.S.R. (2d) 32, 11 C.B.R. (3d) 71, 297 A.P.R. 32 (N.S. T.D.).

FN70. *Sklar-Peppler Furniture Corp.*, *supra*, n. 59 at para. 3.

FN71. *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 1990 CarswellBC 394, [1990] B.C.J. No. 2384, 51 B.C.L.R. (2d) 84, 4 C.B.R. (3d) 311, [1991] 2W.W.R. 136 (B.C. C.A.) at para. 10 [B.C.L.R.]; *Campeau Corp., Re* (1990), *supra*, n. 66 at para. 22 [C.B.R.]; *Citibank Canada v. Chase Manhattan Bank of Canada* (1991), 4 B.L.R. (2d) 147, 2 P.P.S.A.C. (2d) 21, 5 C.B.R. (3d) 165, [1991] O.J. No. 944, 1991 CarswellOnt 182 (Ont. Gen. Div.) at para. 48; and *Canadian Airlines Corp., Re* (2000), 2000 CarswellAlta 622, 19 C.B.R. (4th) 1 (Alta. Q.B.) at para. 12.

FN72. *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293, [1999] O.J. No. 864, 1999 CarswellOnt 792 (Ont. Gen. Div. [Commercial List]) at para. 4.

FN73. *Babcock & Wilcox Canada Ltd., Re* (2000), (2000), 2000 CarswellOnt 704, [2000] O.J. No. 786, 18 C.B.R. (4th) 157, 5 B.L.R. (3d) 75 (Ont. S.C.J. [Commercial List]); *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 1998 CarswellOnt 3346, [1998] O.J. No. 3306, 5 C.B.R. (4th) 299, 72 O.T.C. 99 (Ont. Gen. Div. [Commercial List]); additional reasons at (1998), 1998 CarswellOnt 3347, 5 C.B.R. (4th) 319 (Ont. Gen. Div. [Commercial List]); additional reasons at (1998), 1998 CarswellOnt 3345, 5 C.B.R. (4th) 321 (Ont. Gen. Div. [Commercial List]); leave to appeal refused (1998), 1998 CarswellOnt 5967, 32 C.B.R. (4th) 21 (Ont. C.A.); *Dylex Ltd., Re* (1995), [1995] O.J. No. 595, 1995 CarswellOnt 54, 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]); *Re Royal Oak Mines Inc.* (1999), *supra*, n. 71; *MEI Computer Technology Group Inc., Re*, [2005] Q.J. No. 5744, EYB 2005-90239, [2005] R.J.Q. 1558, 2005 CarswellQue 3675, 19 C.B.R. (5th) 257 (Que. S.C.) at para. 20.

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FN75. (1993), 1993 CarswellOnt 182, [1993] O.J. No. 545, 17 C.B.R. (3d) 1, (sub nom. *Olympia & York Developments Ltd., Re*) 12 O.R. (3d) 500 (Ont. Gen. Div.).

FN76. (1998), 1998 CarswellBC 42, 50 B.C.L.R. (3d) 133, 1 C.B.R. (4th) 49 (B.C. S.C.).

FN77. *Wandlyn Inns Ltd., Re* (1992), 1992 CarswellNB 37, 15 C.B.R. (3d) 316 (N.B. Q.B.).

FN78. *T. Eaton Co., Re* (1999), (1999), 15 C.B.R. (4th) 311, 1999 CarswellOnt 4661, [1999] O.J. No. 5322 (Ont. S.C.J. [Commercial List]).

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