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• MIND THE GAP: PROTECTING CANADIAN ASSETS IN CROSS-BORDER INSOLVENCIES UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT* •

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On September 18, 2009, amendments to the *Companies' Creditors Arrangement Act*[1] and the *Bankruptcy and Insolvency Act*[2] finally came into force in Canada. These amendments (the "2009 Amendments") included substantial amendments to the provisions of the *CCAA* concerning cross-border insolvencies. As expected from such comprehensive reform, gaps in the legislation emerged when the new provisions were put into practice.

This article explains how one such gap was bridged in the context of the Canada-U.S. cross-border filing of TLC Vision Corporation, a New Brunswick corporation with U.S. subsidiaries. Specifically, the article discusses the period between the commencement of the automatic stay of proceedings in the United States on December 21, 2009 and the discretionary stay of proceedings granted by the Ontario Superior Court of Justice (the "Canadian Court") in the Initial Order made on December 23, 2009 in the corresponding Canadian recognition proceeding.[3] As will be discussed in greater detail below, it was possible to protect TLC's Canadian assets from creditors and others during this time through an Interim Initial Order, which provided for a temporary stay of proceedings in Canada, among other relief.

AMENDMENTS TO CROSS-BORDER INSOLVENCIES UNDER THE *CCAA*

The 2009 Amendments included the adoption of a new part IV of the *CCAA* to replace s. 18.6, which had dealt with cross-border insolvencies. Part IV consists of a codified procedure for cross-border insolvencies. This procedure is based on a model law of the United Nations Commission on International Trade Law that had previously been adopted into the insolvency laws of several other countries, including the United States. The amendments are an enhancement to the cross-border protocols that Canadian courts had previously followed.

Part IV permits a debtor company with its "centre of main interests" in a foreign country and some measure of operations and assets in Canada to have its foreign bankruptcy proceeding recognized as a "foreign main proceeding" by a Canadian court. This is not a significant departure from the practice under the old s. 18.6.

However, part IV contains certain technical changes to the initiation of applications for recognition of foreign proceedings in Canada, with important implications for debtor companies and insolvency practitioners. Under the old s. 18.6, a recognition application could be brought by the debtor company immediately following the commencement of the foreign main proceeding. This meant that there was little or no gap between the effective time of the stay of proceeding in the foreign main proceeding and the effective time in Canada.

However, as a result of the 2009 Amendments, the following provisions now apply to foreign recognition applications brought under part IV:

Application for recognition of a foreign proceeding

46. (1) A foreign representative may apply to the court for recognition of the foreign proceeding in respect of which he or she is a foreign representative.

Documents that must accompany application

(2) Subject to subsection (3), the application must be accompanied by

…

(*b*) a certified copy of the instrument, however designated, authorizing the foreign representative to act in that capacity or a certificate from the foreign court affirming the foreign representative's authority to act in that capacity; and

…

Documents may be considered as proof

(3) The court may, without further proof, accept the documents referred to in paragraphs (2)(*a*) and (*b*) as evidence that the proceeding to which they relate is a foreign proceeding and that the applicant is a foreign representative in respect of the foreign proceeding.

Other evidence

(4) In the absence of the documents referred to in paragraphs (2)(*a*) and (*b*), the court may accept any other evidence of the existence of the foreign proceeding and of the foreign representative's authority that it considers appropriate.

…

The *CCAA* defines a "foreign representative" as

a person or body, including one appointed on an interim basis who is authorized in a foreign proceeding regarding a debtor company to

(a) monitor the debtor company's business and financial affairs for the purpose of reorganization; or
(b) act as a representative in respect of the foreign proceeding.[4]

This necessarily means that a foreign main proceeding and a Canadian recognition proceeding cannot be initiated simultaneously, because the application for the Canadian recognition proceeding must be brought by a foreign representative, which requires its appointment by the foreign court prior to the Canadian recognition application. The implication of this change is that a gap may be created between (1) the commencement of the foreign main proceeding and the stay of proceedings in that jurisdiction, if applicable, and (2) the commencement of the Canadian recognition application and stay in Canada. Depending on the length of this gap and the extent of the debtor company's assets in Canada, the vulnerability of these Canadian assets to creditor action may or may not be a significant issue for the debtor company. As described in greater detail below, this vulnerability may be exacerbated by virtue of the automatic stay of proceedings under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code").

U.S. BANKRUPTCY CODE

Under the Bankruptcy Code, the stay of proceedings in respect of a debtor company begins at the moment its Chapter 11 petition is filed.[5] Therefore, the bankruptcy petition, which may be filed electronically, operates as an automatic stay and does not require an order of a U.S. bankruptcy court to take effect, unlike in Canada where the court has discretion to make an order granting a stay.

A debtor company will also typically file several "first-day motions" with the court on the same day the Chapter 11 petition is filed. These motions are intended to facilitate the transition between prepetition and postpetition business operations by, among other things, approving certain regular business practices. Such first-day motions may be administrative or substantive in nature, and may include motions to continue paying compensation and benefits to employees, obtain debtor-in-possession financing and, most relevant to the present discussion, appoint a foreign representative.

The U.S. bankruptcy court hears the first day motions at a "first-day hearing" that typically takes place on the first or second day of the Chapter 11 case, so "first-day orders", including an order to appoint a foreign representative, are usually made a day or two following the filing of the Chapter 11 petition. As a result, the commencement of the stay of proceeding precedes the initial court appearance in the United States.

The issue in Canada-U.S. cross-border insolvency proceedings, therefore, arises as a result of the requirement under s. 46(1) of the *CCAA* for the foreign representative to bring the Canadian recognition application. When the foreign main proceeding is in the United States, the appointment of the foreign representative will not take place until the first-day orders are made. As a result, there is a delay between the commencement of the stays in the United

States and Canada, during which time the debtor company's Canadian assets are vulnerable to the actions of creditors and others. In the Canada-U.S. cross-border case of TLC, this was the very gap that was minimized successfully.

TLC VISION CORPORATION

TLC is one of North America's premier eye care service companies and, together with its subsidiaries, operates in several distinct business lines, including owning and providing management services to refractive laser eye centres in the United States and Canada. Although TLC is a New Brunswick corporation, conducts business and has assets in Ontario, its business and management are primarily U.S.-based, and most of its revenues are generated in the United States.

On December 21, 2009, TLC and two of its U.S. subsidiaries filed petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (the "U.S. Court"). The Chapter 11 proceeding was the foreign main proceeding in this case, as ultimately recognized by the Canadian Court. A Canadian filing under the new part IV of the *CCAA* was necessary in order to obtain the benefit of the U.S. stay of proceedings in Canada and for the purpose of obtaining the Canadian Court's recognition of the principal orders issued by the U.S. Court.

In view of the typical Chapter 11 timeline outlined above, TLC would be unable to obtain an order of the U.S. Court appointing it as foreign representative until December 22, 2009. It would not be until December 23, 2009, at the earliest, that TLC, as foreign representative, would be able to apply for an Initial Order under the *CCAA* recognizing the Chapter 11 proceeding as a foreign main proceeding and granting a stay in respect of TLC in Canada. As a result, TLC found itself facing a potential scenario in which it would have the benefit of the stay of proceedings in the United States without corresponding protection in Canada between December 21 and December 23, 2009.

THE SOLUTION

To avoid this scenario, a solution was necessary to bridge the gap between the commencements of the automatic stay in the United States and the discretionary stay in Canada available after compliance with the technical requirements of the *CCAA*. It was determined that interim relief was required to obtain a short stay of proceedings in Canada during this gap. Absent such relief, TLC's Canadian assets would not be protected.

In applying for interim relief from the Canadian Court, it was submitted on behalf of TLC that Canadian courts have ample jurisdiction to grant such relief. Leading insolvency case law holds that the power of Canadian courts to grant stays is derived both from their inherent jurisdiction and from statute; moreover, stays may be granted whenever it is just and convenient to do so.[6]

This general power is also embodied in the very broad terms of s. 106 of the *Courts of Justice Act* (Ontario), which provides as follows:

> **106.** A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.[7]

Apart from this inherent and general jurisdiction to stay proceedings, Canadian courts are specifically granted the power to order stays under s. 11 of the *CCAA*, which provides as follows:

> **11.** Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.
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> …
>
> **11.02** (1) A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days.
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> …
>
> (2) A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose.
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> …
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> (3) The court shall not make the order unless
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> (a) the applicant satisfies the court that circumstances exist that make the order appropriate; and
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> (b) in the case of an order under subsection (2), the applicant also satisfies the court that the

applicant has acted, and is acting, in good faith and with due diligence.

(4) Orders doing anything referred to in subsection (1) or (2) may only be made under this section.

Citing these sources, an application was made to the Canadian Court for an order granting, among other things, an interim stay of proceedings.[8] On December 21, 2009, the same day the U.S. automatic stay became effective, the Canadian Court granted an Interim Initial Order in respect of TLC (referred to as the "Applicant" in the excerpt below). The order included the following provisions, which track the language used in the model *CCAA* order developed by the model order subcommittee of the Commercial List Users' Committee of the Ontario Superior Court of Justice:

...

STAY OF PROCEEDINGS

2. THIS COURT ORDERS that, subject to further order of this Court, no proceeding or enforcement process in any court or tribunal (each, a "Proceeding"), including a Proceeding taken or that might be taken against the Applicant under the *Bankruptcy and Insolvency Act* (Canada) or the *Winding-up and Restructuring Act*, shall be commenced or continued against or in respect of the Applicant, or affecting the property, assets, rights and undertaking (a term which in this Order includes any and all present and future property of every nature and kind whatsoever, and wheresoever situate, whether real or personal, and including all proceeds thereof, of the Applicant and whether held by the Applicant in whole or in part, directly or indirectly, as principal or nominee, beneficially or otherwise) (the "Property"), except with the written consent of the Applicant, or with leave of this Court, and any and all Proceedings currently under way against or in respect of the Applicant or affecting the Property are hereby stayed and suspended pending further Order of this Court.

EXERCISE OF RIGHTS OR REMEDIES

3. THIS COURT ORDERS that, subject to further order of this Court, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of the Applicant, or affecting the Property, are hereby stayed and suspended except with the written consent of the Applicant and the Information Officer, or leave of this Court, provided that nothing in this Order shall (i) empower the Applicant to carry on any business which the Applicant is not lawfully entitled to carry on, (ii) affect such investigations, actions, suits or proceedings by a regulatory body as are permitted by section 11.1 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, (the "CCAA"), (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

NON-INTERFERENCE WITH RIGHTS

4. THIS COURT ORDERS that, subject to further order of this Court, no Person shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any right, renewal right, contract, agreement, licence or permit in favour of or held by the Applicant, except with the written consent of the Applicant, or leave of this Court.

CONTINUATION OF SERVICES

5. THIS COURT ORDERS that, subject to further order of this Court, all Persons having oral or written agreements with the Applicant or statutory or regulatory mandates for the supply of goods and/or services, including without limitation all computer software, communication and other data services, centralized banking services, payroll services, insurance, transportation, services, utility or other services to the Applicant, are hereby restrained until further Order of this Court from discontinuing, altering, interfering with or terminating the supply of such goods or services as may be required by the Applicant, and that the Applicant shall be entitled to the continued use of its current premises, telephone numbers, facsimile numbers, internet addresses and domain names, provided in each case that the normal prices or charges for all such goods or services received after the date of this Order are paid by the Applicant in accordance with normal payment practices of the Applicant or such other practices as may be agreed upon by the supplier or service provider and the Applicant, or as may be ordered by this Court.

NON-DEROGATION OF RIGHTS

6. THIS COURT ORDERS that, notwithstanding anything else contained herein, no creditor of the Applicant shall be under any obligation after the making of this Order to advance or re-advance any monies or otherwise extend any credit to the Applicant. Nothing in this Order shall derogate from the rights conferred and obligations imposed by the CCAA.

PROCEEDINGS AGAINST DIRECTORS AND OFFICERS

7. THIS COURT ORDERS that, subject to further order of this Court, and except as permitted by Section 11.51(4) of the CCAA, no Proceeding may

> be commenced or continued against any of the former, current or future directors or officers of the Applicant with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of the Applicant whereby the directors or officers are alleged under any law to be liable in their capacity as directors or officers for the payment or performance of such obligations, until a compromise or arrangement in respect of the Applicant, if one is filed, is sanctioned by this Court or is refused by the creditors of the Applicant or this Court.

It should be noted that the Interim Initial Order did not contain any of the restructuring powers that are typical of initial orders made in Canadian recognition proceedings, as it was designed only to protect TLC's Canadian assets during the gap between the commencement of the automatic stay in the United States and the discretionary stay in Canada.

Two days later, on December 23, 2009, following its appointment as foreign representative by the U.S. Court, TLC applied for and was granted an Initial Order largely in the form typically granted in a Canadian recognition proceeding. The Initial Order seamlessly picked up where the Interim Initial Order had left off.

CONCLUSION

Shortly after the enactment of the 2009 Amendments and with no precedents for guidance, a seemingly technical amendment to the *CCAA* with real-world consequence for a restructuring company presented a novel challenge. As described above, the Interim Initial Order provided an elegant solution supported by Canadian insolvency jurisprudence that gave effect to the purpose of the new part IV of the *CCAA* and, most important, protected TLC's Canadian assets during a potentially vulnerable period in its restructuring.

[Adam M. Slavens' practice focuses on corporate and restructuring and insolvency law. He specializes in representing major participants and stakeholders in the financial restructurings of distressed companies in out-of-court workouts and refinancings, as well as formal proceedings under the *Companies' Creditors Arrangement Act* and arrangements under the *Canada Business Corporations Act*.]

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

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

3 The author's firm, Torys LLP, acted as Canadian counsel for TLC. The author acknowledges Michael Rotsztain and Andrew Gray, both of Torys, for coming up with this novel solution.

4 *Supra* note 1, s. 45(1).

5 11 U.S.C. § 362.

6 *Campeau v. Olympia & York Developments Ltd.*, [1992] O.J. No. 1946, 14 C.B.R. (3d) 303 (Ont. Ct. J. (Gen. Div.)) at paras. 14, 16.

7 *Courts of Justice Act*, R.S.O. 1990, c. C.43, s. 106.

8 In addition, s. 61(1) of the *CCAA* provides that nothing in part IV prevents Canadian courts, on the application of a foreign representative or any other interested person, from applying any legal or equitable rules governing the recognition of foreign insolvency orders and assistance to foreign representatives that are not inconsistent with the provisions of the *CCAA*.