AN OVERVIEW OF CANADIAN BANKRUPTCY AND INSOLVENCY LAW

by

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1. INTRODUCTION

Canada is a federal dominion of 10 provinces and 3 territories. Constitutionally, areas of responsibility are allocated between the national, federal government and the local, provincial governments.

Canadian bankruptcy law is under the jurisdiction of the federal government, thus all of Canada is generally governed by a uniform legislative scheme. The two primary pieces of bankruptcy legislation in Canada are the *Bankruptcy and Insolvency Act* (the "BIA") and the *Companies' Creditors Arrangement Act* (the "CCAA"). Provincial legislative jurisdiction covers property and civil rights, and therefore can impact on various insolvency related matters (eg. the rights of secured creditors, landlords, and personal exemptions). The differences that arise between the various provinces is beyond the scope of this paper, but the reader should be aware that differences do exist and local counsel should be consulted in specific cases.

The BIA is the principal federal legislation in Canada applicable to insolvencies. It governs both voluntary and involuntary bankruptcy liquidations as well as debtor reorganizations. The CCAA is specialized companion legislation designed to assist larger corporations to reorganize their affairs and is similar to Chapter 11 of the United States Bankruptcy Code. The reorganization provisions found in the BIA are far more structured and comprehensive than those found in the CCAA. Consequently, the CCAA provides a restructuring corporation with greater flexibility and greater creativity in conducting its reorganization.

[2] The author would like to thank the members of Fraser Milner Casgrain LLP's insolvency and workout team in Calgary for their assistance in the completion of this paper. This includes Quincy Smith, Q.C., John Prowse, Q.C., David LeGeyt, Travis Lysak, Eric Stearns and Derek Pontin. For further information on Fraser Milner Casgrain LLP's Insolvency and Workout Group, please see www.fmc-law.com/insolvency.

2. CORPORATE LIQUIDATIONS

Generally speaking, the liquidation of insolvent entities is governed by the BIA.[3]

(a) The Initiation of Corporate Liquidations under the BIA

A corporation will become bankrupt where:

(i) the corporation makes a voluntary assignment into bankruptcy;

(ii) one or more of the corporation's creditors obtains a Bankruptcy Order against the corporation; or

(iii) the corporation attempts to reorganize under the provisions of the BIA and the attempt at reorganization fails.

A creditor applying for a Bankruptcy Order against a corporation must demonstrate that:

(A) the creditor is owed at least $1,000 by the corporation; and

(B) the corporation has committed an "act of bankruptcy" within the preceding 6 months.

While the BIA enunciates ten specific "acts of bankruptcy", the most common is the failure to meet liabilities generally as they become due. This normally requires evidence of at least two or more creditors who are not being paid by the corporation in the ordinary course of business.

The company has the right to defend the petition. Where such a defence is made, a hearing is held to determine whether the company should be put into bankruptcy.

Whether contested or uncontested, where a Bankruptcy Order is made, the corporation is immediately placed into bankruptcy and all of its assets vest with a trustee in bankruptcy. A trustee in bankruptcy is licensed by the federal authority overseeing the BIA - the Office of the Superintendent of Bankruptcy - is usually an accountant by training, and may hold his or her license through a corporation.

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[3] The liquidation of solvent companies is carried out under applicable federal and provincial corporate legislation and the liquidation of insolvent entities in certain specialized industries (like banking and railways) are carried out under the *Winding-Up and Restructuring Act* (Canada).

(b) **Administration of the Bankruptcy**

(i) Creditors Generally

Upon the granting of a Bankruptcy Order, a trustee is appointed and all of the insolvent's property on the date of the bankruptcy (as well as any property the bankrupt acquires between the date of the bankruptcy and the date of the bankrupt's discharge) vests in the trustee. The trustee's mandate is to liquidate the estate and distribute the proceeds of such liquidation amongst the creditors of the estate.

In order to participate in the administration of the bankruptcy estate, a creditor must file a proof of claim with the trustee in the form prescribed by the BIA. Any decision by the trustee to disallow a claim lodged by a creditor may be appealed to the court. If the claim is approved, the creditor will share in the recovery from any realization on the property of the bankrupt in accordance with the priority regime of the legislation. This regime is examined more closely below, but generally the waterfall of priorities is firstly to crown statutory trusts, then to fund the newly implemented wage earners protection program ("WEPP"), then to secured creditors, followed by preferred creditors and, lastly, to unsecured creditors.

(ii) Priority of Claims

First priority is generally afforded to the Canada's Revenue Agency ("CRA") in respect of un-remitted payroll deductions. Other claims of the CRA are, with certain exceptions, usually given unsecured creditor status.

The next priority is to fund the new WEPP. Essentially, this is designed to ensure that all wage earners collect wages owed to them as soon as possible after the bankruptcy occurs. Under this region an employee may seek up to $3,000 from the government for wages owing up to six months prior to the bankruptcy. The government, in turn, has a subrogated claim for up to $2,000 per employee into the estate.

Secured creditors generally rank next. Secured creditors are generally not effected by a Bankruptcy Order. Upon the granting of a Bankruptcy Order, a secured creditor must make an election to either: (A) surrender its security to the trustee and prove in the bankruptcy as an

unsecured creditor for the entire indebtedness owed to it; or (B) recover its security. Where the secured creditor recovers its security and then liquidates it, it will be entitled to prove as an unsecured creditor in the bankruptcy for any deficiency balance still owed to it by the debtor. Typically, a secured creditor appoints a receiver/manager - either by way of an order of the Court or pursuant to its contractual right to do so under its security - to take possession of the assets and liquidate them to retire the secured obligation.

After crown trust claims, the WEPP, and the claims of secured creditors come the claims of certain creditors that are specifically recognized by the legislation and are paid out in priority to unsecured creditors. These creditors, known as "preferred creditors", get paid in the following priority:

(A) the costs of the administration of the estate;

(B) the levy payable to the government in respect of distributions made by the trustee;

(C) wages owed over the past six months - firstly to the extent not paid under the WEPP, and then to the extent a secured creditor was not able to collect from its collateral that was subject to the WEPP super priority;

(D) municipal taxes that do not form a charge on the real property of the estate;

(E) the landlord, for an amount not exceeding three months arrears and three months accelerated rent, provided the lease provides for it and it does not exceed the value of the assets on the applicable premises;

(F) the costs of a seizing creditor; and

(G) claims of injured employees.[4]

The remaining unsecured creditors will generally share in the remainder of the proceeds of the estate on a *pro rata* basis. While the American doctrine of "equitable subordination" has not been recognized in Canada, there are provisions in the BIA that allow for "silent partner" or "equity" claims to be subordinated to the unsecured creditors of the estate.

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[4] This is an overview only and does not include certain types of claims relating to the bankruptcy of individuals. For greater detail see s.136 of the BIA.

(iii) Administration of the Estate

As the representative of all the unsecured creditors, any rights an unsecured creditor may have against a debtor corporation vest in, and may only be exercised by, the trustee. The trustee has a number of provisions available to it under the BIA to recover payments or transactions that had a prejudicial affect on the estate or preferred one creditor over another. The trustee is also expected to report to the creditors on the conduct of the bankruptcy liquidation and is empowered to conduct special investigations into any suspicious or improper activity made by the debtor prior to bankruptcy on behalf of the unsecured creditors.

(c) **Receiverships**

The other commonly used mechanism to liquidate insolvent entities is pursuant to a receivership. Receiverships are generally instigated by a secured lender of the debtor and take one of two forms. A private, or instrument appointed receiver, is appointed by the lender pursuant to its contractual rights under the lender's security. The receivers rights and powers are established in the instrument, and are therefore of little effect when dealing with third parties.

The second type of receiver is appointed by court Order. Once appointed, the receiver becomes an independent third party (an officer of the court with a duty to all stakeholders) who derives its authority from the terms the order(s) appointing it. As such, a court appointed receiver becomes an effective tool for dealing with all of the debtor's stakeholder groups.

A third type of receiver, known as an interim receiver, has gained popularity in Canada in recent years. Sections 46 and 47 of the BIA provide for the appointment of an interim receiver. An interim receiver can be appointed in a number of situations under the BIA, including:

(i) during the interim period between the filing of a bankruptcy petition and the hearing of the of the petition;

(ii) during the 10 day notice period to enforce security by a secured creditor, it is used to protect them against illegitimate activity while the ten day period passes;

(iii) after the notice of intention to file a proposal has been filed or the proposal itself; and

(iv) after a receiving order has been made but is under appeal.

Generally an interim receiver is appointed when it is shown that it is necessary for the protection of the estate. Section 47 gives the Court broad discretion to vest an interim receiver with any powers that "the court considers advisable". Since the enactment of section 47 the role and authority of interim receivers has been expanded to the point where they are not "interim" at all, and are likened to a quasi-receiver and a trustee in bankruptcy.

3. REORGANIZATIONS

Rather than liquidate, a debtor company may attempt to reorganize or restructure its business by way of the proposal provisions of the BIA or the CCAA. Whereas proposed sections of the BIA are generally used for smaller businesses, the CCAA is intended to facilitate the restructuring of major companies, and therefore requires that a debtor company, or group of debtor companies, has liabilities of at least $5 million.

(a) Reorganization Proceedings Generally

The proposal provisions under both the BIA and CCAA allow the debtor company to obtain a broad stay of proceedings preventing its creditors - and other third parties - from taking steps to enforce their claims, thus allowing the company to formulate a compromise of its indebtedness to those creditors. To seek protection under these regimes, the debtor company must be insolvent on either a liquidity or a balance sheet basis and - in the case of a filing under the CCAA - the debtor company (or companies) must have indebtedness of at least $5 million. The debtor company generally maintains possession and control of its assets under both the BIA and CCAA during the proposal proceedings.

For a proposal to be successful, the majority of creditors in number and two-thirds majority in value of each unsecured creditor class must accept the proposal. Once the creditors approve the proposal, it must be then approved by the court, at which point the proposal becomes binding on all unsecured creditors to whom the proposal was made and those secured creditors in classes where the proposal was accepted.

Under the BIA, where a proposal is rejected by the creditors or if the court does not approve the proposal, the debtor is automatically deemed to be bankrupt. Under the CCAA, if a plan is not accepted by creditors, the company is not automatically bankrupt (although an unsuccessful restructuring generally results in liquidation by way of bankruptcy or receivership proceedings). If creditors reject a proposal made under the CCAA, a company cannot make a second proposal under the BIA.

Under the BIA, if the debtor fails to live up to the terms of its proposal, any creditor can apply to have the proposal annulled. If successful, the annulment may be used to petition the debtor into bankruptcy. If the debtor fails to perform its CCAA reorganization plan relief is available as may be appropriate, although no bankruptcy automatically ensues.

(b) **Procedure for Filing under the BIA or CCAA**

(i) BIA

The filing of a proposal triggers an automatic stay of proceedings pursuant to the provisions of the BIA. The stay may be set aside by either a court order or a rejection of the proposal by the creditors. Generally speaking a debtor is not in a position to file a proposal initially. Instead, the debtor can file a Notice of Intention to Make a Proposal - a prescribed document that triggers the statutory stay of proceedings for 30 days (and any extension allowed by the Court).

If the corporate debtor files a Notice of Intention to make a Proposal under the BIA, it has ten days to file a cash-flow statement and the 30 day stay of the proceedings in which to file a proposal to its creditors. This stay may be extended by order of the Court[5]. The debtor can apply for an extension of the stay of proceedings for no longer than 45 days in each instance, not to exceed a total of five months after the first 30 day period. The stay continues until the earlier of the expiration of this period, the insolvent corporation making a voluntary assignment, or the failure to have a proposal approved or confirmed by the Court.

Upon filing a Notice of Intention to Make a Proposal, the debtor company must select a licensed trustee in bankruptcy to act as the trustee under the proposal. The Trustee's role is to monitor the

[5] s. 50.4 of the BIA

debtor's business until a proposal is accepted or the debtor goes into bankruptcy (in which case the debtor's assets vest with the trustee). The trustee under a proposal is required to notify creditors of the proceedings, report to the creditors if the trustee discovers any material change in the debtor's situation, and call for a meeting of creditors to be held within 21 days from the date the proposal is filed.

(ii) CCAA

Under the CCAA, the process is initiated by a court application which may be done without notice to creditors. Therefore, unlike the BIA, there is no automatic stay upon application - the court must be satisfied that the CCAA applies and that the debtor deserves protection. The initial stay order is restricted to 30 days, although it can be extended on subsequent applications to the court.

Under the CCAA proceeding, a “Monitor” is appointed by the court to monitor the debtor through the proceedings. Its duties are as prescribed in the order appointing it, but are generally similar to the role of a trustee under a proposal described above.

(c) **Stay of Proceedings**

Both the BIA and CCAA allow for a broad stay of proceedings restricting creditors from taking steps to exercise their contractual rights. While the stay is in place, the debtor company is able to carry on business while negotiating with creditors to arrive at a plan of compromise.

Initially, the debtor company gets a stay for no more than 30 days. The debtor must return to court, on notice to all parties, to obtain extensions of this stay. Under a BIA proposal, no single extension can last for more than 45 days, and the aggregate time of extensions cannot go beyond five months from after the initial 30 day period. The CCAA has no restriction on the amount of extensions or the aggregate time required for the restructuring.

At each extension application the debtor must establish that it is proceeding in good faith and with due diligence. Similarly, a creditor may apply to have the court declare the proposal refused before it is even submitted to the creditors for a vote. The court must be satisfied that any one of the following is established:

(i) the debtor is, or has not acted in good faith;

(ii) the proposal is unlikely to be accepted by the creditors; or

(iii) the creditors as a whole would be materially prejudiced if the creditor's application was to be rejected.[6]

The CCAA has similar pre-conditions to a continuation of a stay order.[7] They provide:

(A) circumstances exist that make the order appropriate;

(B) the applicants has acted and continues to act in good faith; and

(C) the applicant has acted and continues to act with due diligence.

In addition to these statutory tests, cases also recognize the "Doomed to Failure Test" - any application to terminate proceedings is evaluated on the basis of whether it is evident that the attempt to reorganize is "doomed to failure".[8] Generally speaking, this type of application is forthcoming when sufficient creditors (either those that hold the voting control or are otherwise key stakeholders in the reorganization) indicate that they will not - under any circumstances - support a reorganization.

(d) **Secured Creditors**

Where a debtor corporation attempts to make a proposal under the BIA or a plan of arrangement under the CCAA, the debtor's secured creditors are prevented from taking any steps to enforce their security.[9]

Under the terms of the proposal, the debtor may divide the secured creditors into different classes and may make different offers to each class according to their commonality of interest - for example, a class for real estate mortgages and another for equipment leases. An insolvent

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[6] s. 50(12) of the BIA.
[7] s. 11(6) of the CCAA.
[8] *Hong Kong Bank of Canada v. Chef Ready Foods* (1990), 4 C.B.R. (3d) 311 (B.C.C.A.).
[9] An exception to this exists under the BIA. In Canada, a secured creditor is required to provide reasonable notice when demanding for repayment of its credit facility. In addition, the secured party must serve a Notice of Intention to Enforce Security on the debtor where the creditor intends to enforce its security over all, or substantially all, of the debtor's receivables, inventory, or property. The Notice is prescribed under the BIA and provides that the secured party cannot enforce on its collateral for 10 days (subject only to getting an interim receiver appointed by the Court). Once the 10 day period passes, the debtor cannot stay that lender in the proposal process under the BIA.

business may make a proposal to some secured creditors while entering separate contracts with others. In the event a proposal is not approved by a particular class of secured creditors, those secured creditors are then free to enforce their security.

The fixing of classes by the court is of particular significance and is often a point of contention between parties. For example, if a particular secured creditor could successfully argue that it has no commonality of interest to any other secured creditor and should thus be in its own class, it gives that creditor greater influence in the restructuring proceedings.

(e) Meeting of Creditors

A meeting of creditors to consider a proposal is governed by statute under the BIA and by court order in the CCAA. Under the BIA, a meeting takes place within 21 days after the filing of the proposal. Prior to the meeting, creditors will receive the pertinent financial information, a list of creditors, a copy of the proposal, and a proof of claim form, proxy and a voting letter.

In a CCAA, it is not uncommon to see the debtor apply for an order authorizing a claims process well in advance of a plan. With very few exceptions, the claims process will be governed by court order. A separate order will then follow setting out the procedure for the meeting(s) of creditors.

If the creditors accept the proposal, the applicant must satisfy the Court that the terms are reasonable and are calculated to benefit the general body of creditors. Generally if a large majority of creditors accept the proposal, the Court will not substitute its judgement over that of the creditors.

4. CROSS-BORDER INSOLVENCY REGIME

Part XIII of the BIA and s. 18.6 of the CCAA were added in 1997 to deal with international insolvencies and recognize comity of law and international coordination. They are attached as Schedule "A" and "B" to this paper for reference. These provisions reflect the fact that, in 1997, Canada had not ratified the UNCITRAL Model Law. Canada has since ratified the UNCITRAL Model Law, so whole-scale revisions to these provisions are slated for proclamation shortly.

The existing cross-border provisions of the BIA and the CCAA are not utilized nearly as often as one might expect. Generally speaking, independent proceedings are commenced in Canada in respect of the Canadian-based entity involved in the insolvency. Where appropriate, a protocol is then implemented with the foreign proceeding that governs the relationship and seeks to ensure that duplication is avoided and processes are coordinated.

5. PROPOSED LEGISLATIVE CHANGES: INSOLVENCY REFORM

In the late 1990s, amendments were made to the Canadian insolvency regimes. Following these changes, the Parliament of Canada created a Committee to review these laws and propose reforms. Concurrently, the Office of the Superintendent established a Personal Insolvency Task Force. Both the Committee and the Task Force released reports and in November 2003 and based on these reports the Senate Committee published a report, *The Standing Senate Committee Report on Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditor Arrangement Act*, which made fifty-three recommendations for bankruptcy and insolvency reform. Some of these recommendations have now been adopted into the legislation, however, some are not yet in force. Below is a review of some of the interesting legislative changes relating to commercial insolvencies and restructurings.

(a) Debtor in Possession Financing

The recent insolvency reform report proposed amendments to the BIA and the CCAA to codify Debtor in Possession Financing ("DIP Financing"). The proposed amendments are outlined in Schedule "C" of this paper.

Prior to these legislative changes, the Courts ability to approve DIP Financing was outlined in the common law as part of the Court's broad discretion under s. 11 of the CCAA or its inherent jurisdiction[10]. The recent codification gives the Court a legislative test and no longer requires a Court to resort to its inherent and equitable jurisdiction. This affords more protection and certainty to DIP lenders and should result in greater access to DIP Financing.

[10] See *Re Sulphur Corporation of Canada Ltd.*, 2002 ABQB 682 and *Re Huners Trailer & Marine Ltd.* (2002), 94 Alta. L.R. (3d) 389.

(b) Eligible Financial Contracts

Under s. 65.1 of the BIA, where a proposal or a notice of intention has been filed, certain rights are stayed, including the right to terminate agreements with the debtor. However, one exception to this is eligible financial contracts which are not subject to these restrictions, and so termination, set off and netting are permitted during the restructuring period. The same exception exists under the CCAA.

The major reform that occurred regarding eligible financial contracts was the change to the definition of "eligible financial contracts". In 2007, both Acts were amended to move the definition to the Regulations, making it easier to further amend the definitions. Under the Act, the Regulations may be made or changed by the Governor in Council. This allows the definition to be changed rapidly in order to reflect changes in the common law and current market standard definitions.

In addition, the definition of eligible financial contract changed from a list type definition to a more comprehensive, conceptual definition. Parts of the list remain under sub-definitions, however, the definition now looks more at the pith and substance of the agreement to determine if it is an eligible financial contract as opposed to whether it falls within a definition in a list. This will allow for the courts to apply a conceptual and pragmatic interpretation of the definition as opposed to having to slot agreements into confined definitions.

The applicable sections of the Acts and the Regulations are reproduced in Schedule "D" of this paper.

6. RECENT DEVELOPMENTS IN CANADIAN INSOLVENCY LAW

Beyond legislative reform, Canadian insolvency law is constantly evolving through judicial interpretation of the legislation. Below are three recent cases that highlight some of the new developments in the Canadian insolvency arena.

(a) Trust Claims Under a Joint Operating Agreement

Vanquish Oil & Gas (“Vanquish”), now in receivership, was a trustee under a joint operating agreement for an oil well. It was required to remit 45% of the well's net production proceeds to a

proportional owner - either Karl Oil and Gas Ltd. or Choice Resources Corporation (who disputed the entitlement at the time).

The joint operating agreement ("JOA") provided that as production revenues were paid to Vanquish, the 45% remittance moneys were deemed to be held in trust for the proportional owner. Under the JOA Vanquish was permitted to intermingle the trust monies. As a result, all revenues were paid into Vanquish's general account.

On March 14, 2007 the general account balance was approximately $40,000. On March 16, 2007 an additional $40,000 was deposited, which moneys were impressed with the trust obligation. On subsequent dates, further proceeds were deposited from other sources that were not expressly subject to the trust obligation. The balance at the time of receivership was approximately $417,000. At this time, Vanquish was in arrears of its trust remittances in the approximate amount of $320,000.

The receiver sold all of the assets of Vanquish on behalf of the secured creditor of Vanquish. The question before the Court was whether the rights of Karl or Choice as trust beneficiary extended to the additional deposits in the general account, or to the proceeds of the sale of the assets of Vanquish, in priority to a secured creditor.

In the result, the Alberta Court of Appeal overturned the finding of the Court below. The Appellate Court found that, upon the insolvency and receivership of the trustee, trust moneys were insulated from the creditors as they did not form a part of the debtor's estate. However, subsequent deposits and sale proceeds were not impressed with a trust and therefore were available for the benefit of the debtor's secured creditor, as the trust agreement did not extend either an express or constructive trust to these moneys. This result could only be avoided if there was clear intent of the trustee to replenish the missing trust funds, which was not the case for Vanquish.

(b) **Stalking Horses & Break Fees**

In *Re: Nortel Networks Corp*. the Ontario Superior Court of Justice considered an application for court approval of the Bidding Procedures pertaining to the sale of Nortel's "Layer 4-7" business, as well as approval of a "Stalking Horse" bidding process.

Prior to filing for protection under the CCAA, Nortel decided that the Layer 4-7 business should be sold. Shortly after filing, Nortel agreed to enter into an Asset Purchase Agreement with Radware for the purchase of the Layer 4-7 business (the "Purchase Agreement").

Given that some of the U.S. debtors were parties to the Purchase Agreement and the desire to maximize the value of the estate, Nortel and Radware agreed that the Purchase Agreement would be subject to higher or better offers under a sale process pursuant to s.363 of the U.S. Bankruptcy Code (the "Code"), and that the initial Purchase Agreement would serve as the "stalking horse" bid pursuant to that process.

The Ontario Supreme Court of Justice approved the Bidding Procedures as set out in the Second Monitor's Report, subject to U.S. bankruptcy approval, as they were in accordance with the procedures in s. 363 of the Code, including the provision that provided for a break fee and expense reimbursement favour of the stalking horse bidder. In view of the relatively small size of the Layer 4-7 business, the court held that although the timelines stipulated in the Bidding Procedures were relatively short, it was desirable to establish the most expedient process to achieve the best realization for stakeholders.

(c) **Recognition of Foreign Proceedings**

Magna Enterprises Corp. ("MEC"), a foreign bankrupt corporation, brought an application for ancillary relief pursuant to s. 18.6 of the CCAA which gives the court the power to "make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under this Act with any foreign proceeding".

MEC was a publicly traded Delaware corporation with its head office in Aurora, Ontario. On March 5, 2009 MEC and certain subsidiaries filed for bankruptcy protection pursuant to Chapter 11 of the United States Bankruptcy Code.

The applicant relied on the fact that, while the restructuring would be principally administered by the U.S. Bankruptcy Court, MEC's management was based in Canada and MEC had assets in Canada. MEC also relied on the following facts to support their s. 18.6 application: (i) MEC and its U.S. Debtor Affiliates had filed for Chapter 11 protection and were operating under the

automatic stay of proceedings such a filing provides; (b) MEC owned and managed horseracing and gambling facilities in the U.S. and Austria, but did not operate any in Canada; (c) MEC only employed 25 residents of Canada at its head office; (d) only 6 of MEC's 50 subsidiaries were Canadian based; (e) for the year ended December 31, 2007, 96.6% of MEC's revenues were generated in the U.S., and no revenues were generated from Canada; (f) MEC had no real properties, fixed assets, or racing licenses in Canada; (g) the MEC restructuring was expected to be complex and require MEC's management in Canada to devote a significant amount of time to the restructuring – a multitude of creditors in Canada would distract management from its task.

In exercising discretion under s. 18.6, the court should consider whether there is a real and substantial connection between a matter and the foreign jurisdiction. Canadian courts have held that "where a cross-border insolvency is most closely connected to one jurisdiction, it is appropriate for the court in that jurisdiction to exercise principal control over the insolvency process in light of the principles of comity and in order to avoid a multiplicity of proceedings". Justice Morawetz found a real and substantial connection between MEC and the United States.

Since all of MEC's management and accounting functions were performed at is head office in Canada and because its restructuring was likely to be complex, thereby requiring MEC's management in Canada to devote significant time to the restructuring, Morawetz J stated that a recognition order and stay in Canada would ensure order, predictability, and fairness. He also held that a stay of proceedings in Canada which mirrors the stay in the U.S. would be of assistance to ensure the orderly restructuring of MEC. The Court granted the following relief:

(a) recognizing the U.S. bankruptcy proceedings;

(b) staying proceedings in Canada in respect of MEC;

(c) prohibiting any interference with the rights of MEC; and

(d) requiring relevant parties to continue to provide services to MEC.

SCHEDULE "A"

PART XIII OF THE *BANKRUPTCY AND INSOLVENCY ACT* - INTERNATIONAL INSOLVENCIES

Interpretation

267. Definitions - In this Part,

"debtor" means in insolvent person who has property in Canada, a bankrupt who has property in Canada or a person who has the status of a bankrupt under foreign law in a foreign proceeding and has property in Canada; ("*débiteur*")

"foreign proceeding" means a judicial or administrative proceeding commenced outside Canada in respect of a debtor, under a law relating to bankruptcy or insolvency and dealing with the collective interests of creditors generally; ("*procédures intentées à l'étranger*")

"foreign representative" means a person, other than a debtor, holding office under the law of a jurisdiction outside Canada who, irrespective of the person's designation, is assigned, under the laws of the jurisdiction outside Canada, functions in connection with a foreign proceeding that are similar to those performed by a trustee, liquidator, administrator or receiver appointed by the court. ("*représentant étranger*")

General

268. (1) Presumption of insolvency - For the purpose of this Part, where a bankruptcy, insolvency or reorganization or like order has been made in respect of a debtor in a foreign proceeding, a certified or exemplified copy of the order is, in the absence of evidence to the contrary, proof that the debtor is insolvent and proof of the appointment of the foreign representative made by the order.

(2) Limitation on trustee's authority - If a foreign proceeding has been commenced and a bankruptcy order or assignment is made under this Act in respect of a debtor, the court may, on application and on any terms that it considers appropriate, limit the property to which the authority of the trustee extends to the property of the debtor situated in Canada and to any property of the debtor outside Canada that the court considers can be effectively administered by the trustee.

(3) Powers of court - The court may, in respect of a debtor, make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under this Act with any foreign proceeding.

(4) Terms and conditions of orders - An order of the court under this Part may be made on such terms and conditions as the court considers appropriate in the circumstances.

(5) Court not prevented from applying certain rules - Nothing in this Part prevents the court, on the application of a foreign representative or any other interested person, from applying such

legal or equitable rules governing the recognition of foreign insolvency orders and assistance to foreign representatives as are not inconsistent with the provisions of this Act.

(6) Court not compelled to give effect to certain orders - Nothing in this Part requires the court to make any order that is not in compliance with the laws of Canada or to enforce any order made by a foreign court.

Recognition of Foreign Proceeding

269. Foreign stays - A stay of proceedings that operates against creditors of a debtor in a foreign proceeding does not apply in respect of creditors who reside or carry on business in Canada with respect to property in Canada unless the stay of proceedings is the result of proceedings taken in Canada.

270. Commencement or continuation of proceedings - A foreign representative may commence and continue proceedings pursuant to sections 43 and 46 to 47.2 and subsections 50(1) and 50.4(1) in respect of a debtor as if the foreign representative were a creditor, trustee, liquidator or receiver of property of the debtor, or the debtor, as the case may be.

271. (1) Court may seek assistance from foreign tribunal - The court may seek the aid and assistance of a court, tribunal or other authority in a foreign proceeding by order or written request or otherwise as the court considers appropriate.

(2) Applications for stays - On application by a foreign representative in respect of a foreign proceeding commenced for the purpose of effecting a composition, an extension of time or a scheme of arrangement in respect of a debtor or in respect of the bankruptcy of a debtor, the court may grant a stay of proceedings against the debtor or the debtor's property in Canada on such terms and for such period as is consistent with the relief provided for under sections 69 to 69.5 in respect of a debtor in Canada who files a notice of intention or a proposal or who becomes bankrupt in Canada, as the case may be.

(3) Powers of court - On application by a foreign representative in respect of a debtor, the court may, where it is satisfied that it is necessary for the protection of the debtor's estate or the interests of a creditor or creditors,

(a) appoint a trustee as interim receiver of all or any part of the debtor's property in Canada, for such term as the court considers appropriate; and

(b) direct the interim receiver to do all or any of the following:

(i) take conservatory measures and summarily dispose of property that is perishable or likely to depreciate rapidly in value,

(ii) take possession of all or part of the debtor's property mentioned in the appointment and exercise such control over the property and over the debtor's business as the court considers appropriate, and

(iii) take such other action as the court considers appropriate.

(4) Application of fees and expenses provision - Section 47.2 applies, with such modifications as the circumstances require, in respect of an interim receiver appointed under subsection (3).

(5) Examination may be authorized - On application of a foreign representative in respect of a debtor, the court may authorize the examination under oath by the foreign representative of the debtor or of any person in relation to the debtor who, if the debtor were a bankrupt referred to in subsection 163(1), would be a person who could be examined under that subsection.

272. Foreign representative status - An application to the court by a foreign representative under this Part does not submit the foreign representative to the jurisdiction of the court for any other purpose except with regard to the costs of the proceedings, but the court may make any order under this Part conditional on the compliance by the foreign representative with any other order of the court.

273. Foreign proceeding appeal - A foreign representative is not prevented from making an application to the court under this Part by reason only that proceedings by way of appeal or review have been taken in a foreign proceeding, and the court may, on an application where such proceedings have been taken, grant relief as if the proceedings had not been taken.

274. Credit for recovery in other jurisdictions - If any bankruptcy order, proposal or assignment is made in respect of a debtor under this Act,

(a) the amount that a creditor receives or is entitled to receive outside Canada by way of a dividend in a foreign proceeding in respect of the debtor, and

(b) the value of any property of the debtor that the creditor acquires outside Canada on account of a provable claim of the creditor or that the creditor acquires outside Canada by way of a transfer that, if it were subject to this Act, would be set aside or reviewed under sections 91 to 101.2,

shall be taken into account in the distribution of dividends to creditors of the debtor in Canada as if they were a part of that distribution, and the creditor is not entitled to receive a dividend from the distribution in Canada until every other creditor who has a claim of equal rank in the order of priority established under this Act has received a dividend, the amount of which is the same percentage of that other creditor's claim as the aggregate of the amount referred to in paragraph (a) and the value referred to in paragraph (b) is of that creditor's claim.

Obligations

275. Claims in foreign currency - A claim for a debt that is payable in a currency other than Canadian currency shall be converted to Canadian currency

(a) in the case of a proposal in respect of an insolvent person and unless otherwise provided in the proposal, where a notice of intention was filed under subsection 50.4(1), as of the day the notice was filed or, if no notice was filed, as of the day the proposal was filed with the official receiver under subsection 62(1);

(b) in the case of a proposal in respect of a bankrupt and unless otherwise provided in the proposal, as of the date of the bankruptcy; or

(c) in the case of a bankruptcy, as of the date of the bankruptcy.

SCHEDULE "B"

COMPANIES' CREDITORS ARRANGEMENT ACT

18.6(1) **Definitions**

In this section,

"**foreign proceeding**" means a judicial or administrative proceeding commenced outside Canada in respect of a debtor under a law relating to bankruptcy or insolvency and dealing with the collective interests of creditors generally;

"**foreign representative**" means a person, other than a debtor, holding office under the law of a jurisdiction outside Canada who, irrespective of the person's designation, is assigned, under the laws of the jurisdiction outside Canada, functions in connection with a foreign proceeding that are similar to those performed by a trustee in bankruptcy, liquidator or other administrator appointed by the court.

18.6(2) **Powers of court**

The court may, in respect of a debtor company, make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under this Act with any foreign proceeding.

18.6(3) **Terms and conditions of orders**

An order of the court under this section may be made on such terms and conditions as the court considers appropriate in the circumstances.

18.6(4) **Court not prevented from applying certain rules**

Nothing in this section prevents the court, on the application of a foreign representative or any other interested person, from applying such legal or equitable rules governing the recognition of foreign insolvency orders and assistance to foreign representatives as are not inconsistent with the provisions of this Act.

18.6(5) **Court not compelled to give effect to certain orders**

Nothing in this section requires the court to make any order that is not in compliance with the laws of Canada or to enforce any order made by a foreign court.

18.6(6) **Court may seek assistance from foreign tribunal**

The court may seek the aid and assistance of a court, tribunal or other authority in a foreign proceeding by order or written request or otherwise as the court considers appropriate.

18.6(7) **Foreign representative status**

An application to the court by a foreign representative under this section does not submit the foreign representative to the jurisdiction of the court for any other purpose except with regard to the costs of the proceedings, but the court may make any order under this section conditional on the compliance by the foreign representative with any other order of the court.

18.6(8) **Claims in foreign currency**

Where a compromise or arrangement is proposed in respect of a debtor company, a claim for a debt that is payable in a currency other than Canadian currency shall be converted to Canadian currency as of the date of the first application made in respect of the company under section 10 unless otherwise provided in the proposed compromise or arrangement.

Proposed Repeal — 18.6

18.6

[Repealed 2005, c, 47, s. 131. Not in force at date of publication.]

SCHEDULE "C" - DEBTOR IN POSSESSION AMENDMENTS

PROPOSED AMENDMENTS TO THE *BANKRUPTCY AND INSOLVENCY ACT*

50.6(1) Order -- interim financing

On application by a debtor in respect of whom a notice of intention was filed under section 50.4 or a proposal was filed under subsection 62(1) and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the debtor's property is subject to a security or charge -- in an amount that the court considers appropriate -- in favour of a person specified in the order who agrees to lend to the debtor an amount approved by the court as being required by the debtor, having regard to the debtor's cash-flow statement referred to in paragraph 50(6)(a) or 50.4(2)(a), as the case may be. The security or charge may not secure an obligation that exists before the order is made.

50.6(2) Individuals

In the case of an individual,

(a) they may not make an application under subsection (1) unless they are carrying on a business; and

(b) only property acquired for or used in relation to the business may be subject to a security or charge.

50.6(3) Priority

The court may order that the security or charge rank in priority over the claim of any secured creditor of the debtor.

50.6(4) Priority -- previous orders

The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order was made.

50.6(5) Factors to be considered

In deciding whether to make an order, the court is to consider, among other things,

(a) the period during which the debtor is expected to be subject to proceedings under this Act;

(b) how the debtor's business and financial affairs are to be managed during the proceedings;

(c) whether the debtor's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable proposal being made in respect of the debtor;

(e) the nature and value of the debtor's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the trustee's report referred to in paragraph 50(6)(b) or 50.4(2)(b), as the case may be.

PROPOSED AMENDMENTS TO THE *COMPANIES' CREDITOR ARRANGEMENT ACT*

11.2(1) Interim financing

On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge -- in an amount that the court considers appropriate -- in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.

11.2(2) Priority -- secured creditors

The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

11.2(3) Priority -- other orders

The court may order that the security or charge rank in priority over any security or charge arising from a previous order made under subsection (1) only with the consent of the person in whose favour the previous order was made.

11.2(4) Factors to be considered

In deciding whether to make an order, the court is to consider, among other things,

(a) the period during which the company is expected to be subject to proceedings under this Act;

(b) how the company's business and financial affairs are to be managed during the proceedings;

(c) whether the company's management has the confidence of its major creditors;

(d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report referred to in paragraph 23(1)(b), if any.

SCHEDULE "D" - ELIGIBLE FINANCIAL CONTRACTS PROVISIONS

SELECTED SECTIONS OF THE *BANKRUPTCY AND INSOLVENCY ACT*

2. Definitions

In this Act,

"eligible financial contract" means an agreement of a prescribed kind;

65.1(1) Certain rights limited

If a notice of intention or a proposal has been filed in respect of an insolvent person, no person may terminate or amend any agreement, including a security agreement, with the insolvent person, or claim an accelerated payment, or a forfeiture of the term, under any agreement, including a security agreement, with the insolvent person, by reason only that

(a) the insolvent person is insolvent; or

(b) a notice of intention or a proposal has been filed in respect of the insolvent person.

65.1(7) Eligible financial contracts

Subsection (1) does not apply

(a) in respect of an eligible financial contract; or

(b) to prevent a member of the Canadian Payments Association established by the Canadian Payments Act from ceasing to act as a clearing agent or a group clearer for an insolvent person in accordance with that Act and the by-laws and rules of that Association.

65.1(9) Permitted actions

Despite subsections 69(1) and 69.1(1), the following actions are permitted in respect of an eligible financial contract that is entered into before the filing, in respect of an insolvent person of a notice of intention or, where no notice of intention is filed, a proposal, and that is terminated on or after that filing, but only in accordance with the provisions of that contract:

(a) the netting or setting off or compensation of obligations between the insolvent person and the other parties to the eligible financial contract; and

(b) any dealing with financial collateral including

(i) the sale or foreclosure or, in the Province of Quebec, the surrender of financial collateral, and

(ii) the setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.

65.1(10) Net termination values

If net termination values determined in accordance with an eligible financial contract referred to in subsection (9) are owed by the insolvent person to another party to the eligible financial contract, that other party is deemed, for the purposes of paragraphs 69(1)(a) and 69.1(1)(a), to be a creditor of the insolvent person with a claim provable in bankruptcy in respect of those net termination values.

ELIGIBLE FINANCIAL CONTRACT GENERAL RULES - SOR 2007-256

Registration November 15, 2007

BANKRUPTCY AND INSOLVENCY ACT

Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act)

P.C. 2007-1731 November 15, 2007

Her Excellency the Governor General in Council, on the recommendation of the Minister of Industry, pursuant to section 209[a] of the *Bankruptcy and Insolvency Act*[b], hereby makes the annexed *Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act)*.

[a] S.C. 1997, c. 12, s. 112

[b] R.S., c. B-3; S.C. 1992, c. 27, s. 2

Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act)

1. The following definitions apply in these Rules.

"derivatives agreement" means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

(a) a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

(b) a futures agreement;

(c) a cap, collar, floor or spread;

(d) an option; and

(e) a spot or forward. (contrat dérivé)

"financial intermediary" means

(a) a clearing agency; or

(b) a person, including a broker, bank or trust company, that in the ordinary course of business maintains securities accounts or futures accounts for others. (intermédiaire financier)

2. The following kinds of financial agreements are prescribed for the purpose of the definition “eligible financial contract” in section 2 of the *Bankruptcy and Insolvency Act*:

(a) a derivatives agreement, whether settled by payment or delivery, that

(i) trades on a futures or options exchange or board, or other regulated market, or

(ii) is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or commodities markets;

(b) an agreement to

(i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,

(ii) clear or settle securities, futures, options or derivatives transactions, or

(iii) act as a depository for securities;

(c) a repurchase, reverse repurchase or buy-sellback agreement with respect to securities or commodities;

(d) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;

(e) any combination of agreements referred to in any of paragraphs (a) to (d);

(f) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (a) to (e);

(g) a master agreement in so far as it is in respect of a master agreement referred to in paragraph (f);

(h) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and

(i) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).

SELECTED SECTIONS OF THE *COMPANIES CREDITOR ARRANGEMENT ACT*

2. Definitions

In this Act,

"eligible financial contract" means an agreement of a prescribed kind;

11.1(2) No stay, etc., in certain cases

No order may be made under this Act staying or restraining the exercise of any right to terminate, amend or claim any accelerated payment under an eligible financial contract or preventing a member of the Canadian Payments Association established by the Canadian Payments Act from ceasing to act as a clearing agent or group clearer for a company in accordance with that Act and the by-laws and rules of that Association.

11.1(3) Permitted actions

The following actions are permitted in respect of an eligible financial contract that is entered into before proceedings under this Act are commenced in respect of the company and is terminated on or after that day, but only in accordance with the provisions of that contract:

(a) the netting or setting off or compensation of obligations between the company and the other parties to the eligible financial contract; and

(b) any dealing with financial collateral including

(i) the sale or foreclosure or, in the Province of Quebec, the surrender of financial collateral, and

(ii) the setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.

11.1(4) Restriction

No order may be made under this Act if the order would have the effect of staying or restraining the actions permitted under subsection (3).

11.1(5) Net termination values

If net termination values determined in accordance with an eligible financial contract referred to in subsection (3) are owed by the company to another party to the eligible financial contract, that other party is deemed to be a creditor of the company with a claim against the company in respect of those net termination values.

11.1(6) Priority

No order may be made under this Act if the order would have the effect of subordinating financial collateral.

ELIGIBLE FINANCIAL CONTRACT GENERAL RULES (COMPANIES' CREDITORS ARRANGEMENT ACT) SOR/2007-257

Registration November 15, 2007

COMPANIES' CREDITORS ARRANGEMENT ACT

Eligible Financial Contract General Rules (Companies' Creditors Arrangement Act)

P.C. 2007-1732 November 15, 2007

Her Excellency the Governor General in Council, on the recommendation of the Minister of Industry, pursuant to subsection 18(1) of the *Companies' Creditors Arrangement Act*, hereby makes the annexed *Eligible Financial Contract General Rules (Companies' Creditors Arrangement Act)*.

Eligible Financial Contract General Rules (Companies' Creditors Arrangement Act)

1. The following definitions apply in these Rules.

"derivatives agreement" means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

(a) a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

(b) a futures agreement;

(c) a cap, collar, floor or spread;

(d) an option; and

(e) a spot or forward. (contrat dérivé)

"financial intermediary" means

(a) a clearing agency; or

(b) a person, including a broker, bank or trust company, that in the ordinary course of business maintains securities accounts or futures accounts for others. (intermédiaire financier)

2. The following kinds of financial agreements are prescribed for the purpose of the definition "eligible financial contract" in section 2 of the Companies' Creditors Arrangement Act:

(a) a derivatives agreement, whether settled by payment or delivery, that

(i) trades on a futures or options exchange or board, or other regulated market, or

(ii) is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or commodities markets;

(b) an agreement to

(i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,

(ii) clear or settle securities, futures, options or derivatives transactions, or

(iii) act as a depository for securities;

(c) a repurchase, reverse repurchase or buy-sellback agreement with respect to securities or commodities;

(d) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;

(e) any combination of agreements referred to in any of paragraphs (a) to (d);

(f) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (a) to (e);

(g) a master agreement in so far as it is in respect of a master agreement referred to in paragraph (f);

(h) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and

(i) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).