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Canadian Cases Under Chapter 15 of the US Bankruptcy Code



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Effective October 17 2005, the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (BAPCPA) ushered in sweeping reforms to the US Bankruptcy Code, including fundamentally altering the legal regime governing the recognition in the US of foreign insolvency proceedings on an ancillary basis.

Since its enactment in 1978, Section 304 of the US Bankruptcy Code had governed the commencement of ancillary bankruptcy proceedings in the US. Section 304 permitted a representative of a debtor in a foreign bankruptcy or insolvency proceeding to commence an ancillary proceeding in the US, typically with the principal objective of obtaining a stay of proceedings in the US. Following the passage of BAPCPA, Section 304 was eliminated and replaced with the far more comprehensive provisions of Chapter 15 of the US Bankruptcy Code. Chapter 15 reflected the US government's adoption of the Model Law on Cross-Border Insolvency prepared by the United Nations Commission on International Trade Law (UNCITRAL). Although the principal purpose of Chapter 15 is unchanged from the days of Section 304 applications – namely, to

facility the commencement of ancillary insolvency proceedings in the US, principally for the purpose of obtaining a stay of proceedings – the changes effected by BAPCPA, both substantively and procedurally, are significant.

Given Canada's physical proximity and close economic ties to the US (with almost \$2 billion in cross-border commerce between the two nations on a daily basis), it is not surprising that Canadian corporations are particularly affected by BAPCPA's elimination of Section 304 and enactment of Chapter 15. In the more than three years since BAPCPA became effective, there have been a number of opportunities for Canadian corporations to test the scope and effectiveness of Chapter 15 in cases such as *MuscleTech*, *MAAX*, *Destinator*, *Tembec*, *Multy Industries* and *Nortel*, and the results have been particularly encouraging.

The Canadian cases under Chapter 15 to date have been highly successful and have consistently affirmed two significant findings. First, Chapter 15 relief is available in a wide variety of circumstances. Second, Chapter 15 relief is broad and may be flexibly tailored to address the facts and requirements of each case.

In the majority of Canadian Chapter 15 cases, the Canadian plenary proceedings in question have consisted of proceedings under the *Companies' Creditors Arrangement Act* (CCAA) (that is to say, typically restructuring or liquidation proceedings on a going concern basis for large corporations).

CANADIAN CHAPTER 15 CASES TO DATE HAVE ESTABLISHED A NUMBER OF IMPORTANT LEGAL PRINCIPALS, FINDINGS AND PRACTICES

However, there have been several Chapter 15 cases involving Canadian receivership proceedings (for example, the *Madill* and *Pope & Talbot* receivership proceedings), and a creative bond recapitalisation that was effected under the *Canada Business Corporations Act* (CBCA) rather than traditional insolvency legislation such as the CCAA was also successful in obtaining relief under Chapter 15. The *Tembec* Chapter 15 proceedings marked the first instance of such proceedings in the context of a CBCA plan of reorganisation.

Canadian Chapter 15 cases to date have established a number of important legal principals, findings and practices with respect to the scope of relief available under Chapter and the manner in which Chapter 15 proceedings will be conducted, including:

- (a) US bankruptcy courts have considerable latitude in assessing a debtor company's "centre

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of main interest” or COMI for the purpose of deciding whether and to what extent relief is available under Chapter 15. Among other things, the location of creditors and sale / revenues and the attachment to US jurisdiction in continuing litigation is not determinative of COMI, and are merely certain factors for consideration;

- (b) US bankruptcy courts have considerable regard for Canadian courts and the Canadian insolvency process, and have a demonstrated comfort level with Canadian courts asserting primary jurisdiction over cross-border matters having a COMI in Canada;
- (c) direct communications by Canadian and US judges are expressly permitted under Chapter 15 and can be both practical and highly effectively (and do not necessitate protocols or other formal arrangements);
- (d) Chapter 15 may be available in cases involving the existence of US operating companies (that is to say, having extensive assets, operations, employees, customers, creditors, in the US) that are part of a larger family of corporations centred in Canada. In an established global corporate community, and with corporations commonly existing as groups rather than stand-alone entities, the US bankruptcy courts have affirmed their willingness to consider the appropriate jurisdiction in which to administer a group of companies’ insolvency proceedings on a centralised basis;
- (e) interim relief pending the hearing of the Chapter 15 application (which does not occur for at least 20 days after the initial filing of the application) is not automatically available to any party under Chapter 15; however, at the discretion of the US bankruptcy court, such interim relief may include:
 - a. permitting partial borrowings under a DIP facility to and including the date of the Chapter 15 hearing, including affirming the grant of a lien to secure such borrowing on the US entities’ assets;
 - b. granting broad injunction relief (that is to say, a temporary restraining order);
 - c. permitting the commencement of a sale process in accordance with a Canadian court order obtained in the plenary Canadian proceedings; and
 - d. granting relief that is only expressly made available to bankruptcy trustees, such as the ability to stay *ipso facto* clauses or to forcibly assign real property leases under Section 365 of the US Bankruptcy Code;
- (f) a stay of proceedings in favour of third parties may be granted by the US court in conjunction with a Chapter 15 application; however, that relief is not provided for pursuant to Chapter 15 itself, even if the application is granted, and must be sought separately;
- (g) practitioners in Canadian plenary proceedings may elect to pursue a Canadian approach throughout, with some degree of comfort that US courts under Chapter 15 will likely not balk merely because that Canadian approach is not identical to the approach that would be taken in plenary proceedings in the US or because the Canadian approach denies a juridical advantage to US creditors, provided that such approach is ultimately fair and impartial. In particular, Section 1506 of the US Bankruptcy Code, which provides that: “Nothing in this chapter prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States”, and the words “manifestly contrary” specifically, will be construed narrowly by the US bankruptcy courts;
- (h) sales processes and resulting transactions that are approved in Canada may be recognised and given effect in the US, including pursuant to the provisions of Section 363 and 365 of the US Bankruptcy Code (which includes the ability to sell free and clear of encumbrances); further, such Canadian sales processes need not conform to US practices or requirements (for example, the use of a stalking horse sale agreement with bid increments, break fees and other common provisions; the use of formal bidding procedure, the holding of an auction);
- (i) broad releases and injunctions that benefit solvent third parties contained in a restructuring plan and/or a Canadian court order sanctioning such plan may be recognised and given effect under in the US pursuant to a Chapter 15 proceeding; and
- (j) US bankruptcy courts may waive compliance under Chapter 15 with various technical requirements, and such discretion may be exercised where the Canadian insolvency proceedings afford protections, procedures or steps that render it unnecessary, duplicative or inefficient to otherwise meet such US technical requirements.

US BANKRUPTCY COURTS HAVE CONSIDERABLE REGARD FOR CANADIAN COURTS AND THE CANADIAN INSOLVENCY PROCESS

The Canadian experience with Chapter 15 to date has affirmed that Canadian corporations requiring some measure of cross-border relief are well situated to seek relief under Chapter 15 in circumstances in which full plenary proceedings under Chapter 11 of the US Bankruptcy Code are not warranted or otherwise feasible.