BIA Still Rules in Labour Matters

GMAC COMMERCIAL CREDIT CORP.-CANADA V. TCT LOGISTICS INC

By Fred Myers

In the recent decision of the Ontario Court of Appeal in *TCT Logistics Inc.*,[1] the Court confirmed the longstanding understanding of the insolvency bar, that in conflicts between bankruptcy law and the provisions of provincial labour law or policy, the federal bankruptcy law governs. The decision also clarifies the practice that had developed since the controversial decision of the Court of Appeal in the *St. Marys Paper* case.[2]

In *St Marys*, the Court of Appeal held that an agreement between a trustee in bankruptcy and a union that allowed the trustee to pay employee pension contributions without becoming liable for accrued pension arrears was not enforceable. The trustee was held to be personally liable for St Marys's accrued pension deficit once the trustee made payments into the pension as if it were the employer.

The lesson of *St Marys* was well understood by practitioners. Since that time, no receiver or trustee has been willing to make pension contributions into a defined benefit pension plan for fear of becoming liable for an unpredictable pension deficit. Similarly, there has been little use in seeking to engage in creative negotiations with union representatives concerning the terms of employment in a receivership or bankruptcy, because any agreements reached could later be held to be unenforceable.

Instead, in preparing draft receivership orders, counsel for receivers and lenders developed language to attempt to provide certainty that receivers and indemnifying creditors would not be liable for pension obligations or other accrued employment liabilities. These orders became increasingly complex over time as counsel devised ways to protect receivers from successor employer liability and other similar provincial labour laws that seek to protect employees' accrued claims by imposing liability on subsequent employers. There were many questions raised as to whether sweeping orders obtained at the outset of a receivership, without notice to employees, unions or other interested parties, could actually accomplish the desired goals -- especially as the orders increased in scope and severity.

In *TCT Logistics*, the Court of Appeal resolved many of the questions in accordance with prevailing law. First and foremost, the Court of Appeal required that Receivers attempt to bargain with unions in order to establish terms of employment that will govern during the receivership, if possible. Recognizing that the result of the *St Marys* decision was a disincentive to this type of collective bargaining, the majority of the Court of Appeal concluded that the Bankruptcy Court can indeed protect agreements reached between unions and receivers. In reaching this conclusion, in her lead judgment for the majority of the Court of Appeal, Madam Justice Feldman labeled the outcome of the *St Marys* case as "unfortunate,"[3] and may well have signaled that *St Marys* should no longer be regarded as good law.

TCT Logistics did not deal specifically with the possibility that, as happens in many cases, the failure of the debtor occurs in such urgent circumstances that there is not enough time for

meaningful negotiations with even one, let alone a number of unions that might be involved. Madam Justice Feldman suggested that if negotiations fail to bear fruit, the Judge hearing the receivership application "will be positioned to assist"[4]. However, the majority did not elaborate on how this would occur.

There are several possibilities. Using powers in the Rules of Civil Procedure to deal with urgent matters for 10 days, the Bankruptcy Court could make an order effectively "without notice" and then require the receiver and the union to spend the time negotiating, perhaps with the assistance of a third-party intermediary. Alternatively, it may be that in some cases, receivers will feel the need to revert to the "old way" and actually shut the debtor's business for a day or two until a deal can be reached with employees.

The principal basis of the protection available to receivers and trustee from pre-existing employment claims is subsection 14.06(1.2) of the Bankruptcy and Insolvency Act (the "BIA"). That section was enacted by Parliament after the decision of the Court of Appeal in *St. Marys*, and is widely believed to have been intended to overrule the case.[5] The difficulty is that subsection 14.06(1.2) is drafted awkwardly. Prior to *TCT Logistics*, there was not yet universal acceptance that the subsection succeeded in protecting receivers fully.

It remained possible that subsection 14.06(1.2) might be interpreted to allow receivers to be held personally liable as successor employers in a manner which might allow a provincial labour board to calculate a receiver's liability based upon seniority or service accrued by employees for the debtor prior to the receiver's appointment. In *TCT Logistics* however, Madam Justice Feldman wrote that while a receiver may be liable as a successor employer, its liability is "only for obligations incurred after the date of the bankruptcy or receivership".[6]

The formal Order of the Court of Appeal has yet to be issued in *TCT Logistics*. However, it may be that the majority Reasons and the formal order will bring sufficient clarity to the scope of subsection 14.06(1.2) that the risk associated with a finding of successor employment or similar findings, as was experienced in *St Marys*, will be resolved. That is, lenders will be far less concerned about the risks associated with a finding that a receiver is a successor employer if they can be assured at the outset that such a finding will be limited to employment obligations that accrue during the period of the receivership.

As was the case in *St. Marys* itself, trustees have often been willing to recognize existing benefits or to provide enhanced employment benefits in order to seek to obtain the cooperation and participation of employees in a going concern realization process. Although the Court of Appeal went out of its way to find that collective agreements are not automatically terminated in a receivership or upon bankruptcy[7] , this is not the real issue in practice. Rather, the issue of real concern is the risk that by paying employee wages, benefits, pensions or other forms of remuneration during a receivership, the receiver, trustee or indemnifying creditor may become exposed to liability for a massive and possibly a completely unexpected pension deficit or other set of pre-existing obligations which undercuts the economic basis for the going concern realization effort.

The issue that has attracted the Union's attempt to appeal *TCT Logistics* to the Supreme Court of Canada is the technical question of the test that is to be applied when a union seeks leave under section 215 of the BIA to bring successor employer proceedings against a receiver or trustee in bankruptcy before a provincial labour board. The union argued that the test for lifting the stay under section 215 of the BIA to allow proceedings to be brought outside of the bankruptcy itself is generally not an onerous burden to meet. Most cases asserted against a bankrupt estate or a receivership are allowed to be heard and are subjected to only minimal scrutiny on the merits.

However, the majority of the Court of Appeal refused to accept that limited scrutiny is always the sole governing approach to the question of whether leave ought to be granted to allow proceedings to be brought outside of the bankruptcy forum. The Court of Appeal reiterated that it is the role of the Bankruptcy Court, and no other tribunal, to balance the affected interests that arise in making fundamental decisions concerning the bankruptcy or insolvency process. The decision of whether or not a receiver will operate the business and employ the employees of the debtor is such a fundamental decision.

The existence and scope of potential personal liability of the receiver as a successor employer could affect the entire conduct of the proceeding and determine whether the debtor will be liquidated or operated pending a going concern sale process. The proposed claim affects not just the quantum of claims against the estate, but the fundamental decisions taken by the receiver during the receivership process in the interest of all stakeholders, including employees themselves. The majority of the Court of Appeal determined that before such a central aspect of a receivership or bankruptcy is questioned before another tribunal, the Bankruptcy Court is the gatekeeper under section 215 of the BIA and it is required to determine whether the proposed proceedings are appropriate.

In *TCT Logistics*, the Bankruptcy Judge had originally refused to allow the union to bring proceedings against the receiver because the receiver was realizing on assets rather than acting as a traditional employer. This "qua realizor" test developed from a line of cases that had culminated in the recent decision of Farley J. in *Re Royal Crest Lifecare Group Inc*[8]. The majority of the Court of Appeal held that this was not the proper approach. Rather, they referred the case back to the Bankruptcy Judge to determine if, in balancing all of the relevant factors, proceedings to seek to impose successor employer liability against the receiver best fulfill the goals of the BIA by promoting the best result for creditors, the debtor and other stakeholders.

Where holding a receiver liable under provincial labour law would be contrary to the best outcome of the receivership, for example, by preventing the receiver from operating the business, the Court of Appeal relied upon the doctrine of constitutional paramountcy to reiterate Parliament's supremacy in cases where provincial legislation conflicts with federal legislation. Prior cases had established that even where there is a low burden to meet, there should be careful scrutiny of attempts to obtain leave to proceed against receivers and trustees.[9]

The case law also already recognized that in making decisions as to whether to grant or refuse leave, it was appropriate for the Bankruptcy Court to balance policy and other broad factors.[10] In *TCT Logistics*, the majority listed relevant factors[11] for consideration by the Bankruptcy Court and contemplated that by application of the relevant factors, a receiver could obtain certainty as to its potential liability at the outset of the process when it makes the determination of whether to operate the business.[12]

A significant practical issue arises in cases, like *TCT Logistics* itself, where a union seeks to bring successor employer proceedings at the end of the process after the receiver has already decided to operate the business and conducted a going concern sale process. The problem is exacerbated by the fact that the secured creditor in *TCT Logistics* stands to suffer a substantial shortfall despite the operation of the business.

Presumably the Bankruptcy Court will weigh the timing of the leave application and the outcome of the process into its leave decision in accordance with the factors listed by Feldman J.A. However, the risk of a decision late in the process is troubling. A late decision could render a receiver or an indemnifying creditor liable for unquantifiable or unexpected liabilities after steps have been taken that could have been avoided had the risk of liability been known. This may carry risks that may be too high for future receivers. Receivers and creditors need certainty as to their potential liabilities at the outset in order to undertake the risks of operating the business. Indemnifying creditors cannot be expected to allow receivers to incur liabilities at the end of a process where the liabilities outweigh the benefits gained by the operation of the business.

It is feared that the uncertainty associated with the potential for receivers to be held liable for pre-receivership employment obligations will result in more debtors being liquidated as receivers and creditors become unwilling to operate the debtor's business without assurances that there will be no such liability. As noted above, subsection 14.06(1.2) of the BIA as interpreted in *TCT Logistics* may now resolve the problem by limiting the scope of liabilities of receivers. Similarly, an early agreement between the receiver and the relevant union protected by an Order of the Bankruptcy Court that cannot be questioned in any other forum could also provide the certainty required to allow a receiver to operate a business and employ employees.

As the pre-receivership discussions mandated by *TCT Logistics* commence, the insolvency and employment bars will come to know each other better. It may be that a new

regime will emerge to replace and provide a more acceptable result than the post-*St. Marys* use of broad declaratory orders obtained without notice. Until the new practice emerges however, great care is required to ensure that receivers, trustees and indemnifying creditors understand the risks associated with the exercise by the Bankruptcy Court of its gatekeeper function.

As noted by Feldman J.A., "If the receiver can show that by operating the business for a short time it can maximize the value of the business for the benefit of creditors and, at the same time, thereby save as many jobs as possible, it will make sense for the court to deny leave..." These are the recognized goals of the BIA and of virtually every realization process. The question is whether creditors or receivers will be able to establish these factors in sufficient time to allow the receiver to operate the business at the outset of the proceeding. We expect that the Bankruptcy Court well understands these issues and the need for certainty. Time will tell if this confidence can be projected into action and if the risks of operating the business are rewarded by enhanced realization and job savings or penalized by decreased recovery and a return to the unfortunate days of *St Marys*."

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GMAC Commercial Credit Corp.-Canada v. TCT Logistics Inc (2004), 48 C.B.R. (4th) 256 (Ont. C.A.)

2 *Re St. Marys Paper Inc.* (1994), 19 O.R. (3d) 163 (C.A.)

3 *TCT Logistics, supra, Reasons of Feldman J.A., at paragraph 63*

4 *TCT Logistics, supra, Reasons of Feldman J.A., at paragraph 62*

5 S.C. 1997, c.12, s.15

6 *TCT Logistics, supra, Reasons of Feldman J.A., at paragraph 33*

7 *TCT Logistics, supra, Reasons of Feldman J.A., at paragraph 51*

8 (2003), 40 C.B.R. (4th) 146 (Ont. S.C.) aff'd [2004] O.J. No. 174 (C.A.)

9 *Third Generation Realty Ltd. v. Twigg Holdings Ltd et al. (1992), 9 C.P.C. (3d) 387 (Ont. Gen Div.)*

10 See, for example, *Mancini (Bankrupt) et al. v. Falconi et al. (1993), 61 O.A.C. 332 (C.A.)* at paragraph 24 where the Court of Appeal refers to the nature of the duties of the trustee, the interests of creditors and the public interest as being among the relevant factors in the balancing process.

11 In paragraph 58 of her Reasons, Feldman J.A. listed factors such as, the timing of the application for leave, the complexity of the receivership, the demands on the receiver as it carries out its obligations, the potential duration of the period that the receiver intends to operate the business before it can be sold and others as relevant considerations.

12 *TCT Logistics, supra, Reasons of Feldman J.A., at paragraph 61*