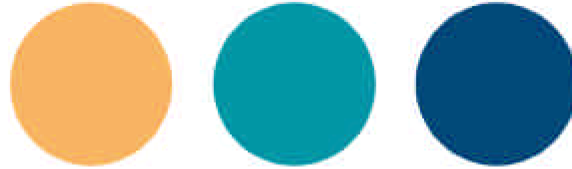

Insolvency In The Telecommunications Industry:
A Canadian Perspective

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PART I. INTRODUCTION 1

PART II. BANKRUPTCY AND INSOLVENCY LAWS IN CANADA 1

1. Proceedings under the *Bankruptcy and Insolvency Act* ("BIA") 1

A. Bankruptcy 1

B. Reorganization under the BIA 2

C. Miscellaneous Provisions 4

2. Proceedings under the *Companies' Creditors Arrangement Act* ("CCAA") 4

A. CCAA Proceedings Generally 4

B. Procedure 4

C. Stay Of Proceedings 4

D. Monitor 5

E. Plan Of Compromise Or Arrangement 5

3. Receivership 5

PART III. CROSS-BORDER INSOLVENCY PROCEEDINGS 6

2. Types of Cross-Border Proceedings 6

A. Ancillary / Recognition Proceedings in Canada 6

B. Part XIII of the BIA 7

C. Section 18.6 of the CCAA 8

D. Recognition in Canada of Other Insolvency Proceedings 11

E. Section 304 Ancillary / Recognition Proceedings in the United States 11

F. Concurrent Restructuring and Bankruptcy Proceedings 13

PART IV. INSOLVENCY ISSUES IN THE TELECOMMUNICATIONS INDUSTRY 13

1. Unique Nature of Assets and Services 13

A. Co-ordination of Cross-Border Proceedings 14

B. Necessity for Continued Operations 15

2. Regulatory Framework 16

A. Licenses 16

B. Restrictions on Foreign Ownership 20

3. Structural Subordination 22

PART V. CONCLUSION 23

SCHEDULE "A" – Part XIII of the *Bankruptcy and Insolvency Act*

SCHEDULE "B" – Section 18.6 of the *Companies' Creditors Arrangement Act*

SCHEDULE "C" – Legislation in Canada Pertaining to the Telecommunications Industry

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PART I. INTRODUCTION

The collapse of the dot-com market in late 2000 through 2001 left few segments of the telecommunications industry unscathed. Demand for band-width-related services has declined, as has investor confidence in internet and telecommunications companies. As a result, Canada, like other parts of the world, has experienced a proliferation of high profile bankruptcies and restructurings of telecommunications companies, with more likely to come. The unique asset base of telecommunications companies, the regulatory framework and the circumstances surrounding the high tech boom and subsequent collapse lead to unique issues faced by insolvency practitioners upon the collapse of a telecommunications company.

As a starting point for this paper, we propose to examine, in general terms, the bankruptcy and insolvency laws of Canada and how they operate, followed by a general discussion of cross-border insolvency proceedings. With this background, we will then address some of the specific laws and issues involving an insolvency in the telecommunications industry as they relate to Canada.

PART II. BANKRUPTCY AND INSOLVENCY LAWS IN CANADA

1. Proceedings under the *Bankruptcy and Insolvency Act* ("BIA")

A. Bankruptcy

(a) How a Bankruptcy Occurs

A bankruptcy in Canada may occur: (i) by a voluntary assignment by a debtor; (ii) by a receiving order declaring a debtor bankrupt granted by a court in response to a petition of one or more creditors; (iii) by the failure to approve an insolvent debtor's restructuring proposal by its unsecured creditors or by the court; and (iv) by a restructuring proposal being subsequently annulled by the court, usually as a result of the debtor's default under the proposal.

(b) Effect of Bankruptcy

The administration of a bankruptcy is performed by a trustee in bankruptcy, as supervised by a board of inspectors elected by the creditors. Upon a bankruptcy, all of the debtor's assets

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vest in the trustee. Numerous actions of the trustee, such as the sale of assets, compromise of claims or continuance of the business, require the approval of the inspectors. A stay of proceedings is effected against unsecured creditors, but secured creditors may, upon the trustee's confirmation of the validity of their respective security, exercise their rights in respect of their security. Certain preferred creditors, such as employee claims for wages, are accorded statutory priority over general unsecured creditors.

B. Reorganization under the BIA

(a) Proposals

Canadian bankruptcy legislation provides debtors with a means of making restructuring proposals to their creditors, both secured and unsecured, in order that the debtor might effect a restructuring.

A proposal may be made by an insolvent person, as defined in the BIA. The proposal must be made by the debtor or a person acting on the debtor's behalf. A creditor cannot file a proposal. A proposal under the BIA must name a trustee in bankruptcy to act as trustee under the proposal. The trustee's role is significant and includes assisting the debtor in preparing financial information and reporting to creditors and the court. A proposal is initiated when it is filed with the Official Receiver, the government appointee responsible for administering the BIA.

(b) Notice Of Intention To File A Proposal

A debtor may initiate a reorganization by filing a proposal or, alternatively, by filing a notice of intention to file a proposal. A notice of intention is filed with the Official Receiver and includes the consent of a trustee in bankruptcy who has agreed to act for the purpose of the proposal. Unlike a proposal, a notice of intention may only be filed by an insolvent person, and not by a bankrupt, trustee, receiver or liquidator. Thus, a notice of intention is intended for troubled businesses not yet subject to bankruptcy or receivership proceedings.

After filing a notice of intention, a debtor has 30 days to file a proposal, subject to such extensions as a court may grant. Extensions cannot exceed 45 days at a time. The BIA imposes a maximum extension of five additional months and requires that extensions be solely for the purpose of enabling the debtor to file a proposal. Once a proposal is filed, the trustee is required to hold a meeting of the affected creditors within 21 days. Creditors are entitled to 10 days notice of the meeting. Therefore, in light of the aforementioned time periods, the debtor who files a notice of intention and who receives the maximum number of extensions may have as much as 6 months with which to complete its restructuring under the BIA. There is no jurisdiction to extend the proposal period beyond this 6 month period. If the proposal is not completed in that time, the debtor is put into bankruptcy, i.e. liquidation.

(c) Stay Of Proceedings

Upon the filing of a notice of intention or a proposal, the BIA provides for an automatic stay of all proceedings which is binding on all creditors and the federal and provincial governments. The automatic stay is binding on secured creditors who are automatically precluded from relying on provisions in security agreements and other contractual arrangements

which purport to terminate the debtor's ability to deal with the corresponding collateral upon insolvency or the filing of a proposal or notice of intention.

The automatic stay provisions in the BIA which are triggered upon the filing of a notice of intention or a proposal also prohibit a third party from terminating, amending or accelerating payment under a contract with the debtor. For example, as a result of these provisions, hydro, telephone, cable and utility companies are prohibited from terminating their supply of services to the debtor, although third parties are entitled to demand payment in cash for all goods and services supplied to the debtor after the date of the filing. Landlords, lessors and licensors are similarly prohibited from terminating their respective contractual agreements by reason of defaults by the debtor which occurred prior to the filing of the proposal or notice of intention. The BIA stipulates that these provisions may not be waived or varied in advance by contract.

(d) Disclaimer Of Leases

A debtor who is proposing a reorganization or proposal under the BIA may, on 30 days notice to the affected landlord, disclaim a commercial lease provided that the exercise of this right is limited to the period of time between the filing of a notice of intention and the filing of a proposal, or on the filing of the proposal. Landlords affected by the debtor's right to disclaim may file a proof of claim in the proposal. A landlord may object to a proposed disclaimer by applying for a court declaration that the disclaimer does not apply to a particular lease. In such cases, the court must grant the declaration unless the debtor satisfies the court that the debtor's ability to make a viable proposal to its creditors will be jeopardized absent the leases in question being disclaimed.

(e) Classes Of Creditors

Proposals under the BIA may be made to creditors generally or to classes of creditors. Proposals may deal with claims of secured creditors which the debtor wishes to compromise. The BIA requires that where a proposal is made to a secured creditor, it must also be made to all other secured creditors in that class. As a result of a debtor's ability to deliberately choose to include or exclude a class of secured creditors from its proposal, a debtor can determine which secured creditors the stay of proceedings is to be imposed upon.

The BIA provides guidelines for determining appropriate classes of creditors and also grants the courts the power to classify creditors. Unsecured creditors usually form a single class. Secured creditors are usually grouped according to "commonality of interests".

(f) Voting And Approval

All classes of creditors to which a proposal has been made are entitled to vote. A proposal will be accepted if it has the support of 50% in number and two thirds in value of each class of unsecured creditors. Any secured class which rejects a proposal that has been accepted by the unsecured creditors will not be bound by the proposal and will be entitled to pursue their remedies as they see fit. In the event that a proposal is not approved by the unsecured creditors, the debtor is automatically deemed bankrupt, with the bankruptcy deemed to be effective as of the earlier of the date of filing the proposal and the date of filing the notice of intention, if any. A debtor may also be immediately placed into bankruptcy if the debtor defaults in the performance of its proposal and the default is not waived or remedied.

C. Miscellaneous Provisions

The BIA contains additional provisions relating to a variety of issues which may arise during the course of insolvency proceedings. For example, the rights and obligations of receivers, both privately and court-appointed, are set out in considerable detail (see Section 3 of this part for a further discussion on receivers). In addition, limited environmental protections are provided for receivers and trustees. The BIA also contains provisions in respect of international insolvencies (as discussed in further detail below).

2. Proceedings under the *Companies' Creditors Arrangement Act* ("CCAA")

A. CCAA Proceedings Generally

The CCAA has a broad, remedial purpose and is intended to give a debtor an opportunity to restructure (short of bankruptcy, foreclosure or receivership proceedings) by means of a plan of compromise or arrangement. The CCAA is distinct from the BIA. The Act is quite short, providing debtors with considerable flexibility to restructure. In recent years, there has been increasing use of the CCAA as a result of the broad interpretation given the CCAA by the courts and the absence of statutory rules of procedure under the CCAA. In practice, a CCAA proceeding operates very similar to a Chapter 11 proceeding in the United States.

B. Procedure

In order to initiate CCAA proceedings, an application must be brought by any person with "an interest in the matter" (usually the debtor, but also creditors). The application is brought before a court in which the corporation has its head office or chief place of business in Canada. The applicant generally seeks a declaration that the debtor is a corporation to which the CCAA applies, a stay of proceedings against the debtor, an order that the debtor file a plan of compromise or arrangement within a certain time frame and call a meeting of affected creditors to vote on the plan. The CCAA applies to a corporation only if: (i) it is a Canadian corporation, has assets in Canada or carries on business in Canada; (ii) is bankrupt, insolvent, has committed an "act of bankruptcy", as defined in the BIA, or is deemed insolvent within the meaning of the *Winding-Up and Restructuring Act*; and (iii) has outstanding indebtedness in excess of $5 million.

C. Stay Of Proceedings

Initially, the stay of proceedings granted in a CCAA initial order is limited by statute to no more than 30 days. Thereafter, extensions of the stay are in the discretion of the court on notice to the interested parties. Since it is an order of the court which imposes a stay of proceedings (and not the CCAA itself), it is customary for the initial order to include a request for assistance from other courts in other jurisdictions, including other provinces in Canada and in the United States, to enforce its terms.

The stay of proceedings is generally imposed against secured creditors, unsecured creditors and certain non-creditors such as landlords, utility companies, telephone companies, etc. It is customary for a stay of proceedings to include a prohibition to prevent creditors and non-creditors alike from exercising contractual rights that would otherwise undermine the corporation's attempts to restructure. The courts may not stay certain claims against directors

and may not prohibit a supplier of goods and services from requiring immediate payment in respect of all goods and services ordered after the initial order is made.

D. Monitor

A debtor remains in possession of its assets during a CCAA restructuring. The CCAA requires that the court appoint a monitor to supervise and assist the debtor corporation in preparing financial information and preparing the plan of compromise or arrangement. In Canada, the monitor is usually a major accounting firm, which reports to the court and the creditors as to the actions of the debtor corporation and ensures that the relative positions of the creditors remain unaffected pending voting and approval of the plan.

E. Plan Of Compromise Or Arrangement

The debtor will, in the course of the CCAA proceedings, divide its creditors into classes according to their interests. A plan of compromise or arrangement must be approved by both a majority of creditors having two thirds in value of the claims of each class and by the court supervising the CCAA process. If the plan is sanctioned by the court, it is binding on all affected creditors (including those who voted against the plan or opted not to participate in the proceedings). The courts will only sanction a plan that is fair and reasonable and which balances the interests of creditors, the company and its stakeholders. The courts have also allowed a debtor, while continuing its restructuring efforts with a view to developing a plan of arrangement, to commence a parallel process of exploring third party transactions.

3. Receivership

In Canada, a receiver may be privately-appointed or appointed by court order. A private receiver is normally appointed by a secured creditor where its security documents provide for such an appointment upon default by the debtor. A private receiver is, for certain purposes, the agent of the secured creditor appointing it, and for other purposes (such as carrying on the business), the agent of the debtor. Before being appointed, a private receiver should verify the validity and enforceability of the secured creditor's security and that the BIA notice provisions have been complied with. A wrongful appointment of a receiver may subject the secured creditor and receiver to liability.

The Judicature Acts of the Canadian common law provinces allow the court to appoint a receiver or receiver and manager wherever the court determines it to be "just and convenient" to do so. The courts have traditionally appointed a receiver where a secured creditor with a contractual right to appoint a receiver requests the appointment as part of an interlocutory proceeding within an action commenced by a secured creditor. The usual appointment order stays proceedings against the receiver and the debtor and sets out the powers of the receiver. A court-appointed receiver obtains its power and authority to act from the court appointing it. Unlike a private receiver, a court-appointed receiver is an officer of the court with a duty to act in the interests of all creditors. A court-appointed receivership may be appropriate where: (a) there are highly contentious or complex proceedings; or (b) the debtor is refusing to co-operate with its secured creditor or grant access to the assets charged by the secured creditor's security.

PART III. CROSS-BORDER INSOLVENCY PROCEEDINGS

It is increasingly uncommon to encounter a commercial insolvency which is confined to a single jurisdiction. Affiliated corporate entities, their businesses and their assets are frequently located across multiple jurisdictions. This is especially the case upon an insolvency of a telecommunications company, as will be explained in further detail below.

In North America, most comprehensive cross-border insolvencies involve corporations and businesses in Canada and the United States operating concurrently under:

(a) the CCAA and Chapter 11 of the United States Bankruptcy Code (the "U.S. Code"), in the case of restructurings of individual international corporations or of related corporate entities; and

(b) the BIA and Chapter 7 of the U.S. Code, in the case of bankruptcies of related corporations.

Alternatively, in some cases, insolvency proceedings may be commenced primarily in one country, with ancillary proceedings taken in the other country to recognize and give effect to the primary proceedings. Examples include:

(a) the bankruptcy of a single corporation with assets in multiple jurisdictions where a trustee in bankruptcy or "administrator" is appointed in one country and requires recognition in another jurisdiction;

(b) the appointment of a receiver / receiver and manager / interim receiver which requires recognition in another jurisdiction; and

(c) the commencement of restructuring proceedings under the laws of one country in respect of a corporation also having assets or operations in other countries.

In order to obtain recognition in the United States of an insolvency proceeding commenced in Canada, an application may be made pursuant to Section 304 of the U.S. Code. Conversely, Part XIII of the BIA and Section 18.6 of the CCAA contain provisions for the recognition in Canada of foreign insolvency proceedings.

2. <u>Types of Cross-Border Proceedings</u>

A. Ancillary / Recognition Proceedings in Canada

General principles regarding the enforcement of foreign judgments in Canada, which are rooted in the principle of comity of nations, have traditionally developed through Canadian case law. The most significant recent development in this area is the decision of the Supreme Court of Canada in *Morguard Investments Ltd. v. De Savoye* (1991), 2 W.W.R. 217 (S.C.C.). In this unanimous decision, the Supreme Court of Canada recognized that changing commercial realities require a flexible and global approach to the enforcement of foreign judgments. Although this case dealt with the recognition of extra-provincial judgments, it has consistently been applied to American and other foreign judgments.

In the insolvency context, this common law approach has been supplanted largely by statutory amendments designed to codify and clarify the common law. In April 1997, each of the BIA and the CCAA was amended to, *inter alia*, add provisions to each Act addressing, for the first time, international insolvency issues (Part XIII of the BIA and Section 18.6 of the CCAA, respectively). The intention behind these provisions was two-fold. First, Canadian courts have been given the power to adopt a wide range of measures aimed at facilitating co-operation between the various jurisdictions affected by international insolvencies involving an insolvent or bankrupt having property in Canada. Each of the BIA and the CCAA provide that the courts may make such orders and grant such relief as they consider appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under the BIA or the CCAA, as the case may be, with any foreign proceedings (Section 268(3) of the BIA and Section 18.6(2) of the CCAA).[1] The Canadian courts may also seek the aid and assistance of a court, tribunal or other authority in a foreign proceeding. Second, the Canadian courts are expressly authorized to recognize a "foreign representative", who is defined as a person, other than the debtor, who is assigned, under the laws of the jurisdiction outside Canada, functions that are similar to those performed by a trustee, liquidator, administrator or receiver appointed by the court (Section 267 of the BIA and Section 18.6(1) of the CCAA).

B. Part XIII of the BIA

Part XIII of the BIA was enacted as part of amendments made to the BIA in 1997 and provides, for the first time, codification and clarification of the domestic rules applicable to international insolvencies in order to promote greater co-operation and co-ordination with other jurisdictions. A copy of Part XIII of the BIA is attached as Schedule "A".

For Part XIII to apply, a debtor must have property in Canada, however, the debtor need not be a Canadian resident. The debtor must also be insolvent, bankrupt or have the status of a bankrupt in another jurisdiction. By taking proceedings under Part XIII of the BIA, a foreign representative does not attorn to the jurisdiction of the Canadian court except for liability for costs (Section 272). Accordingly, a foreign representative may make use of Part XIII without being subject to the full jurisdiction of a Canadian court. However, the court, in making an order under Part XIII, may make such order conditional on compliance by the foreign representative with any other order of the court (Section 272).

A foreign order to stay proceedings in regard to property situated in Canada is not automatically recognized under Canadian law. In fact, Section 269 of the BIA expressly provides that 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. Accordingly, a foreign representative must obtain from a Canadian court a stay of proceedings in Canada in accordance with Section 269 of the BIA. Pursuant to Section 271(2), upon hearing an 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

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[1] Chapter 11 proceedings under the U.S. Code have been held to fall generally within the definition of a foreign proceeding. See *Re Babcock & Wilcox Canada Ltd.* (2000), 18 C.B.R. (4th) 157 (Ont. S.C.J.) and *Re Kaiser Aluminum Corp*. (January 14, 2003), No. 03-CL-4837 (Ont. S.C.J.), Farley J., unreported.

arrangement in respect of a debtor or in respect of the bankruptcy of a debtor, a Canadian bankruptcy 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 the corresponding stay provisions of the BIA (i.e. Sections 69 to 69.5).

Section 268 of the BIA contains several provisions designed to ensure that the powers of the Canadian bankruptcy courts are not unduly limited or constrained. Section 268(4) provides that an order of a Canadian bankruptcy court under Part XIII of the BIA may be made "on such terms and conditions as the court considers appropriate in the circumstances", while Section 268(5) provides that nothing in Part XIII of the BIA prevents a 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 the BIA". Finally, Section 268(6) provides that nothing in Part XIII of the BIA requires a Canadian bankruptcy 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. Taken together, these provisions ensure that the Canadian bankruptcy courts have ample flexibility, authority and discretion in responding to the facts and circumstances of each particular case.

The powers of a foreign representative recognized in Canada under Part XIII of the BIA include:

(a) the right to file a petition for a receiving order against the debtor;

(b) the right to make a proposal;

(c) the right to petition the Canadian courts to appoint an interim receiver in respect of all or any part of the debtor's property in Canada;

(d) the right, in certain circumstances, to petition the courts in Canada to obtain a stay of proceedings against the debtor or the debtor's property in Canada; and

(e) the right to petition the courts to allow the foreign representative the opportunity of examining under oath the debtor or any other person reasonably thought to have knowledge of the affairs of the debtor or any agent, clerk, servant, officer, director or employee of the debtor (Section 271).

C. Section 18.6 of the CCAA

Provisions similar to Part XIII of the BIA were enacted as part of amendments made to the CCAA in 1997 (see Section 18.6). However, consistent with the general approach by the Parliament of Canada to each of the BIA and the CCAA, the provisions contained in Part XIII of the BIA are more fulsome than Section 18.6. In *Re Babcock,* Farley J. characterized the difference between Part XIII of the BIA and Section 18.6 of the CCAA in the following manner:

> I think it a fair observation that the BIA is a rather defined code which goes into extensive detail. This should be contrasted with the CCAA which is a very short general statute which has been utilized to give flexibility to meet what might be described as the peculiar and unusual situation circumstances. A general

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> categorization (which of course is never completely accurate) is that the BIA may be seen as being used for more run of the mill cases whereas the CCAA may be seen as facilitating the more unique or complicated cases. Certainly the CCAA provides the flexibility to deal with the thornier questions. Thus I do not think it unusual that the draftees of the 1997 Amendments would have it in their minds that the provisions of the CCAA dealing with foreign proceedings should continue to reflect this broader and more flexible approach in keeping with the general provisions of the CCAA, in contrast with the corresponding provisions under the BIA. [para. 13]

Section 18.6(3), (4) and (5) of the CCAA contain provisions identical to Section 268(4), (5) and (6) of the BIA (i.e. the broad provisions which ensure that the Canadian courts have ample flexibility, authority and discretion in responding to the facts and circumstances of each particular case). Similar to the BIA, Section 18.6(7) of the CCAA expressly provides that a foreign representative who brings an application before a Canadian court pursuant to Section 18.6 of the CCAA does not attorn to the jurisdiction of the Canadian court except for liability for costs. A copy of Section 18.6 of the CCAA is attached as Schedule "B".

Section 18.6 of the CCAA employs the same definitions of "foreign proceeding" and "foreign representative" as are used in Part XIII of the BIA. However, the definition of "debtor company" in the CCAA differs from that of "debtor" in Part XIII of the BIA. Whereas the BIA definition expressly requires that a debtor have property located in Canada, there is no such requirement under the CCAA. A "debtor company" need only be, effectively, insolvent or bankrupt. However, recent case law has expanded even this requirement and held that, unlike the BIA, a person that is not insolvent (i.e. a solvent Canadian affiliate of an insolvent corporation that has commenced Chapter 11 proceedings in the United States) may bring an application for limited relief under Section 18.6(4) of the CCAA (see *Re Babcock, Re Kaiser Aluminum Corp*.). In *Re Babcock*, Farley J. used Section 18.6 of the CCAA to grant a stay of proceedings against the solvent Canadian subsidiary of a U.S. parent with asbestos claims that had filed for Chapter 11 protection. In *Re Kaiser Aluminum Corp.*, Farley J. used Section 18.6 of the CCAA to grant a stay of proceedings, in effect, to prevent the Pension Benefits Guaranty Corp. in the United States from attaching a lien against the assets of Kaiser's Canadian subsidiaries.

In reaching these conclusions, the Court stressed that the definitions of "foreign proceeding" and "foreign representative" in Section 18.6 referred to a "debtor" (an undefined term in the CCAA) as opposed to a debtor company. The Court also held that Section 18.6(4) of the CCAA may be utilized to deal with situations where, notwithstanding that a full filing is not being made under the CCAA, ancillary relief is required in connection with a foreign proceeding. In any event, Section 18.6(4) expressly requires that the relief requested not be inconsistent with, or of a nature contrary to, the provisions of the CCAA.

In *Re Babcock, supra*, Farley J. went further and attempted to provide some very useful guidance to the profession as to the principles which should govern the application of Section 18.6 in future cases:

(a) The recognition of comity and co-operation between the courts of various jurisdictions are to be encouraged.

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(b) Respect should be accorded to the overall thrust of foreign bankruptcy and insolvency legislation in any analysis, unless in substance generally it is so different from the bankruptcy and insolvency law of Canada or perhaps because the legal process that generates the foreign order diverges radically from the process here in Canada.

(c) All stakeholders are to be treated equitably, and to the extent reasonably possible, common or like stakeholders are to be treated equally, regardless of the jurisdiction in which they reside.

(d) The enterprise is to be permitted to implement a plan so as to reorganize as a global unit, especially where there is an established interdependence on a transnational basis of the enterprise and to the extent reasonably practicable, one jurisdiction should take charge of the principal administration of the enterprise's reorganization, where such principal type approach will facilitate a potential reorganization and which respects the claims of the stakeholders and does not inappropriately detract from the net benefits which may be available from alternative approaches.

(e) The role of the court and the extent of the jurisdiction it exercises will vary on a case by case basis and depend to a significant degree upon the court's nexus to that enterprise; in considering the appropriate level of its involvement, the court would consider:

  (i) the location of the debtor's principal operations, undertaking and assets;

  (ii) the location of the debtor's stakeholders;

  (iii) the development of the law in each jurisdiction to address the specific problems of the debtor and the enterprise;

  (iv) the substantive and procedural law which may be applied so that the aspect of undue prejudice may be analyzed;

  (v) such other factors as may be appropriate in the instant circumstances.

(f) Where one jurisdiction has an ancillary role,

  (i) the court in the ancillary jurisdiction should be provided with information on an ongoing basis and be kept apprised of developments in respect of that debtor's reorganizational efforts in the foreign jurisdiction;

  (ii) stakeholders in the ancillary jurisdiction should be afforded appropriate access to the proceedings in the principal jurisdiction.

(g) As effective notice as is reasonably practicable in the circumstances should be given to all affected stakeholders, with an opportunity for such stakeholders to come back into the court to review the granted order with a view, if thought

desirable, to rescind or vary the granted order or to obtain any other appropriate relief in the circumstances. [para. 21]

D. Recognition in Canada of Other Insolvency Proceedings

There may be foreign insolvency proceedings to which neither the BIA nor the CCAA apply or are relevant. For example, a foreign receivership proceeding may not lend itself to relief under either the BIA or the CCAA (as it would not usually entail corollary or ancillary proceedings under the BIA or the CCAA). In these cases, recognition of the foreign proceeding may be sought before the Canadian courts based on the rules and principles of private international law (as opposed to statutory provisions such as Part XIII of the BIA and Section 18.6 of the CCAA).

The common law has established that a Canadian court may recognize a foreign receiver and grant such receiver the authority necessary to fulfill its obligations with respect to property located in Canada. Generally, a foreign receiver will be permitted to take proceedings in Canada to protect its claim to the assets of the debtor and the Canadian courts will recognize and enforce the priority that is conferred by the foreign security. However, the Canadian courts must be satisfied that: (i) the security interest granted to the creditor by the debtor is enforceable in the domestic jurisdiction; (ii) the foreign court must have been competent to make the appointment; and (iii) there must be sufficient connection between the debtor and the jurisdiction in which the foreign receiver was appointed to justify the Canadian court's recognition of the foreign court's order.

E. Section 304 Ancillary / Recognition Proceedings in the United States

In 1978, the U.S. Code was enacted by the Congress of the United States, including Section 304. Section 304 of the U.S. Code serves as an acknowledgment by the United States of the existence and validity of foreign bankruptcy proceedings, and is at the same time an attempt to assist in the administration of those foreign bankruptcy proceedings where assets of the foreign debtors are located in the United States. Section 304 permits a "foreign representative" of a debtor to file a petition under Section 304 with the bankruptcy court to obtain orders to assist in the administration of those foreign bankruptcy proceedings. A petition pursuant to Section 304 is an ancillary proceeding to the bankruptcy proceeding in the debtor's home country (as opposed to an independent or more fulsome proceeding).

A petition under Section 304 is commenced with the filing by a foreign representative of an insolvent debtor of a petition under Section 304 with the bankruptcy court, generally in the district where the foreign debtor has a principal place of business, maintains a business operation or where the principal assets of that foreign debtor are located. Specifically:

(a) where an injunction is sought against an action or proceeding or the enforcement of a judgment against the debtor or its property, the petition must be commenced in the district court for the district where the action or proceeding against which the injunction is sought;

(b) where the foreign representative seeks to enjoin the enforcement of a lien against property, or require the turnover of the debtor's property, the petition must be commenced in a district court for the district where the property is located; and

(c) where some other form of relief is sought, the petition must be filed in the district court for the district in which the foreign debtor's principal business is located, or where its principal assets in the United States are located.

A "foreign representative" of the debtor is defined in Section 101(24) of the U.S. Code as a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding" and a "foreign proceeding" is defined in Section 101(23) of the U.S. Code as a "proceeding, whether judicial or administrative, and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge or effecting a reorganization."

Section 304(b) sets out a list of remedies available to the foreign representative at the discretion of the bankruptcy court after the petition has been granted pursuant to Section 304(a). The bankruptcy court may:

(d) enjoin the commencement or continuation of any action against a debtor with respect to property involved in such foreign proceeding or such property or the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;

(e) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or

(f) grant any other order for appropriate relief.

It should be noted that, in accordance with Section 304(b), a stay of proceedings is not automatic upon the filing of a Section 304 petition and is instead a matter of judicial discretion. A party requiring an immediate stay of proceedings may need to seek a preliminary injunction or temporary restraining order concurrent with the filing of the petition under Section 304(a) (although pursuing these additional remedies may amount to attornment to the jurisdiction of the United States courts, unlike a proceeding strictly within the scope of Section 304).

If no interested party objects to the Section 304 petition, then the U.S. Bankruptcy Court may order the relief requested by the foreign representative in the petition without a formal hearing. Alternatively, if one or more of the interested parties objects to the petition, the requested relief may be ordered only after notice and a hearing is conducted on the objection.

Section 304(c) of the U.S. Code lists six factors which are considered by the U.S. Bankruptcy Court in determining whether or not to grant the relief requested by the foreign representative in the petition. Those six factors are:

(g) just treatment of all holders of claims against or interests in such estate;

(h) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;

(i) prevention of preferential or fraudulent dispositions of property of such estate;

(j) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;

(k) comity; and

(l) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

F. Concurrent Restructuring and Bankruptcy Proceedings

Where fulsome proceedings are to be conducted in both Canada and the United States concurrently (i.e. under the BIA or the CCAA, and under Chapter 7 or Chapter 11 of the Code, respectively), the ordinary rules, procedures and substantive law of the two countries apply to the proceedings within their respective jurisdictions. Typically, these concurrent proceedings are co-ordinated through the use of court-ordered protocols approved and ordered by both courts.

It is beyond the scope of this paper to provide a thorough review of the customary workings of fulsome bankruptcy and restructuring proceedings under BIA, the CCAA, and the U.S. Code. It is sufficient to note that, in a corporate context, the principal types of proceedings are bankruptcies under the BIA and Chapter 7 of the Code and restructurings under either the BIA or the CCAA, and Chapter 11 of the Code. In most respects, and notwithstanding that there must be a practical co-ordination of efforts and processes, each of the concurrent proceedings is commenced, continued and completed in essentially the same manner it would be irrespective of the concurrent proceedings in the other jurisdiction. In other words, the substantive and legal requirements for any given proceeding are not varied simply because there are concurrent proceedings in another jurisdiction (but again, this may be affected somewhat by the use of protocols).

Based on the case law that has emerged to date, it appears that the decision as to which course of action to pursue in Canadian cross-border insolvency proceedings (i.e. whether to pursue Section 304 proceedings or Chapter 11 proceedings in the United States) will be largely dependent upon the significance and materiality of the debtor corporation's presence, directly or through its subsidiaries, in the United States. As a debtor's ties to the United States increase (whether as a result of assets and operations located in the United States, the existence of subsidiary corporations incorporated and resident in the United States or the existence of customers and creditors resident in the United States), it is more likely that Chapter 11 proceedings will be required by the Courts for the administration of the U.S. assets.

PART IV. INSOLVENCY ISSUES IN THE TELECOMMUNICATIONS INDUSTRY

1. Unique Nature of Assets and Services

Telecommunications companies provide a wide range of services requiring a diverse and unique asset base. For example, a telecommunications company may provide internet, high-speed data and voice services, delivered over fibre, wireless or digital subscriber technologies.

In order to service a broad range of customers, a telecommunications company will likely expand its corporate structure to include subsidiaries located in other jurisdictions and its assets, such as fibre optic cables, may cross jurisdictional boundaries. As such, an insolvency of a telecommunications company will likely require the co-ordination of cross-border proceedings. Further, because many of the businesses operated by telecommunications companies are federally regulated and provide important services to the public, in order to preserve value in the company, an insolvency of a telecommunications company often requires the continued operation of the company during the bankruptcy or restructuring process.

A. Co-ordination of Cross-Border Proceedings

As discussed above, there are a variety of methods available to co-ordinate cross-border proceedings. Determining which method should be employed involves an examination of the debtor's ties to the other jurisdiction. A case study involving two high profile restructurings demonstrates the difficulty faced by telecommunications companies in their efforts to determine the appropriate method of co-ordinating cross-border proceedings.

(a) Teleglobe

Teleglobe Inc. ("Teleglobe") is a Canadian company which commenced operations in 1987, providing wholesaling services to other carriers in the telecommunications business. By 2002, Teleglobe was a leader in the telecommunications industry and had diversified its business into such areas as web hosting and global data and voice networks. However, Teleglobe's growth and operations strategies had resulted in enormous debt levels which the company was unable to sustain. Teleglobe found itself saddled with a $4 billion debt, including a $1.25 billion U.S. bank loan due to mature on July 22, 2002. Teleglobe's troubles climaxed on April 24, 2002, when BCE Inc., Teleglobe's parent corporation, unilaterally cut off long-term funding to Teleglobe and said it was giving up on the company and would be taking a charge of up to $8.5 billion.

In light of its financial woes, Teleglobe and 19 of its subsidiaries filed for protection under the CCAA on May 15, 2002. At that time, the company indicated in a press release that it intended to seek similar protection in both the United Kingdom and the United States. Accordingly, on May 15, 2002, the company commenced ancillary proceedings in the United States pursuant to Section 304 of the U.S. Code and the Delaware bankruptcy court granted a temporary restraining order. On May 20, 2002, certain of Teleglobe's subsidiaries in the United Kingdom commenced administration proceedings under the *Insolvency Act of 1986* in the High Court of Justice – Chancery Division in London, England.

On May 24, 2002, the Delaware court declined Teleglobe's Section 304 application that its Canadian insolvency protection status be recognized in the United States for its U.S. operations. Although the U.S. Bankruptcy Court granted that request for the Montreal-based company's Canadian entities, it did not do so for the company's U.S. subsidiaries. As a result of this decision, Teleglobe Communications Corporation and 10 affiliates were forced to file Chapter 11 petitions in the U.S. Bankruptcy Court in Delaware, thereby abandoning the hoped-for ancillary proceedings in the United States.

Teleglobe had initially applied for protection under Section 304 of the U.S. Code for recognition of the Canadian CCAA order and, in particular, the stay of proceedings contained in

the CCAA order. However, this application was opposed by the United States Trustee (the "UST"), who argued: (i) that the U.S. Court lacked subject matter jurisdiction as to certain of the petitioners (i.e. the U.S. subsidiaries) who did not qualify as debtors in "foreign proceedings" within the meaning of Section 101(23) of the U.S. Code; and (ii) that the requested relief was too broad for those entities over whom the U.S. Court lacked subject matter jurisdiction.

The UST noted that only 9 of the 20 petitioners, including Teleglobe, were Canadian entities, and that the remaining 11 petitioners, all direct or indirect subsidiaries of Teleglobe, were incorporated in, and had their principal place of business in, the United States. None of the U.S. subsidiaries owned any interest in Teleglobe's Canadian subsidiaries. The U.S. Court accepted that the U.S. subsidiaries did not have a domicile, residence, principal location of business or location of principal assets in a "foreign" country and that, accordingly, these petitioners could not obtain relief pursuant to Section 304 of the U.S. Code. The U.S. Court therefore concluded that it did not have subject matter jurisdiction under Section 304 with respect to the U.S. subsidiaries. The U.S. subsidiaries commenced proceedings under Chapter 11 of the U.S. Code before the temporary restraining order expired.

(b) GT Group Telecom

An interesting contrast to Teleglobe is the recent case of GT Group Telecom Inc. and its respective Canadian and American wholly-owned operating subsidiaries, GT Group Telecom Services Corp. and GT Group Telecom Services (USA) Corp. (collectively, "GT"). GT was Canada's largest independent, facilities-based telecommunications provider offering high-speed data, internet, application and voice services. GT had local offices in 17 markets across nine provinces in Canada, with its headquarters in Toronto, Ontario.

On June 26, 2002, GT sought and obtained court-protection under the CCAA and indicated its intention to file ancillary proceedings in the United States. The CCAA proceedings became necessary due to the deteriorating financial status of GT and the likelihood of insolvency proceedings became evident after the company had warned that, notwithstanding its informal restructuring efforts announced February 19, 2002, the company expected to violate the terms of a revenue covenant (i.e. $260 million on a rolling four quarter basis) contained in its secured debt facilities upon completion of the quarter ending June 30, 2002.

On June 28, 2002, GT obtained relief under Section 304 of the U.S. Code from the U.S. Bankruptcy Court for the Southern District of New York, which relief was subsequently extended. In contrast to Teleglobe, it would appear that the GT case was an appropriate one in which to seek relief under Section 304 of the U.S. Code since GT did not have the strong ties to the United States that characterized Teleglobe's U.S. subsidiaries. Although GT Group Telecom Services (USA) Corp. ("GT USA") was incorporated in the United States, this corporation accounted for only a small proportion of GT's overall business. Further, although GT USA was registered to carry on business in various States in the United States, including New York, GT USA did not have any offices or employees located in the United States, as all of its books and records and bank accounts were maintained in Ontario.

B. Necessity for Continued Operations

The telecommunications industry is extremely competitive and services a large number of customers. It has become the accepted practice that services to these customers not be cut off

without allowing the customers an opportunity to migrate to another carrier. These factors, coupled with the regulatory environment, requires the continued operation of a telecommunications company over the course of its restructuring in order to achieve maximum values for stakeholders.

The necessity for continued operations poses its own set out problems. For example, an experienced team with expertise in the telecommunications area must be assembled to assist in running the business during the restructuring process, leading to increased costs.

The unique nature of a telecommunications company's assets and services also leads to increased regulation of the telecommunications industry.

2. Regulatory Framework

In Canada, what legislation is applicable and what governmental agency is responsible for regulating a telecommunications company depends upon the services provided by the telecommunications company and the facilities used, i.e., wireless or wireline.

The Canadian Radio-television and Telecommunications Commission (the "CRTC") has jurisdiction pursuant to the *Telecommunications Act* to regulate matters such as the rates, terms and conditions under which Canadian carriers, including both wireline and wireless carriers, provide service, the exchange of telecommunications traffic between carriers and inter-carrier arrangements. The CRTC is also mandated to establish the appropriate rules for entry into new markets and the regulation of competitive telecommunications markets. In addition, the CRTC regulates ownership and control of facilities-based providers.

The Department of Industry, Science and Technology ("Industry Canada") is the department within the Government of Canada that authorizes and regulates the use of, and allocates, radio spectrum – i.e., wireless frequencies pursuant to the *Radiocommunication Act*, by way of a licensing scheme. A company that does not provide wireless services and provides only wireline services is not subject to the licensing scheme regulated by Industry Canada.

In the case of wireless carriers, Industry Canada and the CRTC share responsibility for enforcing the restrictions on foreign ownership and control that apply to telecommunications common carriers.

A. Licenses

A license, which is generally subject to transfer restrictions, is required depending upon the functions performed by a telecommunications company and the technology used. Whether or not a license is required will be of paramount importance upon the insolvency of a telecommunications company as it may limit the pool of potential purchasers and affect the company's ability to restructure.

(a) Spectrum Licences

In order to offer certain wireless services to customers, a telecommunications company must obtain certain licenses, which licenses allow the company to operate radio apparatus and

use wireless frequencies known as radio spectrum. These licenses are authorized and regulated by Industry Canada.

The *Radiocommunication Act* provides Industry Canada with wide discretion to issue radio licences for the operations of radio apparatus and spectrum licences for the use of radio spectrum within a defined geographic area, establish technical standards in relation to radio equipment and plan the allocation and use of radio spectrum taking into account the orderly establishment and modification of radio stations. The Minister also has the discretion to amend the terms and conditions of licences to ensure the orderly development and efficient operation of radiocommunications in Canada.

Radio and spectrum licences are issued for a term and may be renewed at Industry Canada's discretion. They may be suspended or revoked for cause, on notice and after giving the licence holder a reasonable opportunity to make representations, where the Minister is satisfied the holder has contravened the Act, the regulations or the terms or conditions of its licenses. As part of a licensing policy established by the Minister in 1995, a spectrum aggregation limit, or "spectrum cap" was put in place, restricting to 40 MHz the amount of mobile spectrum any one licensee and its affiliates could hold in a specific geographic area. In 1999, the mobile spectrum cap was raised to 55 MHz. Most importantly, radio and spectrum licenses are generally subject to transfer restrictions and Industry Canada has taken an aggressive view on licenses.

As such, a transfer of these licenses as part of a restructuring is subject to the prior approval of Industry Canada. In deciding whether or not to grant its approval to a transfer of license, Industry Canada will review a potential purchaser's business plan in order to determine whether it meets the terms and restrictions attached to the license and Industry Canada's criteria. In addition, any potential purchaser must meet the foreign ownership requirements and approval will not be given if the purchaser cannot meet these requirements. Further, Industry Canada views a receiver as someone who effectively operates the business; a receiver is someone other than the licensee using the license. As such, Industry Canada's prior consent is required to an appointment of a receiver over the assets of a telecommunications company when such assets include a license. If such consent is given, the Minister will grant an interim operating authority allowing the receiver to use the license on a temporary basis.

Therefore, upon a restructuring of a telecommunications company providing wireless services, the transfer restrictions and prior approval process in respect of radio and spectrum licenses may limit the number of viable purchasers and lengthen the restructuring process, thereby increasing costs due to the necessity for continued operations.

(b) Other Licenses and Authorizations

Although a telecommunications common carrier is subject to regulation by the CRTC, no license is generally required to provide services.[2] There are particular activities, however, that require a service provider to obtain either a license or certification from the CRTC.

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[2] The CRTC requires registration of different classes of service providers (i.e., resellers, non-dominant carriers and wireless service providers). However, such registrations are a simple matter of filing a letter with the CRTC.

(i) International Service License

For example, if a telecommunications service provider offers international services, a license from the CRTC is required. However, there is no scarcity to these licenses; they are granted on a regular basis. As such, there is no real value to these licenses, other than avoiding the 45 day waiting period generally required to obtain such a license. Therefore, although prior approval is required to transfer a license to provide international services, this should not unduly hinder the restructuring process.

(ii) Certification

A telecommunications company providing either or both wireless and wireline services may operate as a local exchange carrier, either as an incumbent local exchange carrier ("ILEC"), an example of which is Bell Canada, or as a competitive local exchange carrier ("CLEC"), an example of which is AT&T Canada.

The CRTC considers CLECs to be "non-dominant carriers". As such, they are not subject to the same degree of regulation as ILECs and are not required to file tariffs for their rates for end-customer services. However, the CRTC requires CLECs to assume certain regulatory obligations and CLECs are subject to certification. Although a CLEC certification is not scarce, there is a significant waiting period and expense involved in meeting the requirements and negotiating the agreements to become certified as a CLEC. Accordingly, certification effectively has value in a restructuring.

The rules regarding certification do not explicitly include any requirements regarding the transfer of certification from one entity to another; however, prudence dictates that prior approval from the CRTC be obtained to transfer a CLEC's assets to a new entity. This requirement could impact on the restructuring of a CLEC.

(c) Recent Decisions

(i) *Nextwave*

On January 23, 2003, the United States Supreme Court released its decision in *Federal Communications Commission v. Nextwave Personal Communications Inc. et al.*[3], which decision, read narrowly, prohibits a governmental agency from cancelling licenses sold at auction solely for non-payment by the debtor and, read broadly, appears to favour the restructuring of a telecommunications company even over the objection of a governmental agency.

In 1993, Congress amended the Communications Act of 1934 to authorize the FCC to award spectrum licenses through a system of competitive bidding. In response to this amendment and to achieve the goals expressed by Congress, namely, the promotion of economic opportunity and competition and the avoidance of excessive concentration of licenses, the FCC decided to award licenses for broadband personal communications services through

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[3] [2003] WL 166615 (U.S.).

simultaneous, multiple-round auctions. Nextwave Personal Communications, Inc. and Nextwave Power Partners, Inc. (collectively, "Nextwave") purchased certain spectrum licenses at an auction held by the FCC. In accordance with FCC regulations, Nextwave made a downpayment on the purchase price, signed promissory notes for the balance, and executed security agreements that the FCC perfected by filing under the Uniform Commercial Code. The licenses were conditional upon the full and timely payment of all monies due pursuant to the terms of the FCC's instalment plan. In addition, the licenses provided that failure to comply with this condition would result in the automatic cancellation of the licenses. Nextwave experienced financial difficulties and filed for Chapter 11 bankruptcy protection. Nextwave suspended payments to all creditors, including the FCC, pending confirmation of a reorganization plan. The FCC objected to Nextwave's reorganization plan asserting that Nextwave's licenses had been cancelled automatically when Nextwave missed its first payment deadline. The FCC simultaneously announced that Nextwave's licenses were available for auction.

The Bankruptcy Court invalidated the cancellation of the licenses as a violation of various Bankruptcy Code provisions, but the Second Circuit reversed, holding that exclusive jurisdiction to review the FCC's regulatory action lay in the courts of appeal. After the FCC denied Nextwave's petition for reconsideration of the license cancellation, the District of Columbia Circuit held that the cancellation violated 11 U.S.C. §525(a), which provides that a governmental unit may not revoke a license to a debtor solely because such debtor has not paid a debt that is dischargeable in the case. The United States Supreme Court upheld the lower court decision holding that the FCC's revocation of Nextwave's licenses was unlawful. In particular, the United States Supreme Court rejected the claim that the Bankruptcy Code obstructs the Communications Act auction provisions since nothing in the auction provisions demands that cancellation be the sanction for failure to make agreed-upon periodic payments or even requires the FCC to permit payments to be made over time.[4]

(ii) Impact in Canada

The decision of the United States Supreme Court in *Nextwave* appears to turn on the following factors: (a) the purchase of licenses at auction; (b) the debtor's non-payment under an instalment plan; and (c) §525(a) of the Bankruptcy Code. An application of these factors to the situation in Canada reveals that, read narrowly, the decision may not have a large impact on the telecommunications industry in Canada.

Although Industry Canada had traditionally assigned portions of radio spectrum on a first-come, first-served basis or a comparative selection process, in February 1996, Industry Canada announced an alternative auction process, to be used in certain instances.[5] In August 1998, Industry Canada issued a general framework it expected to follow for spectrum auctions. Among the key features are the following: (i) auctions are to be preceded by full public consultation; (ii) consultations on bandwidth and the geographic scope of licenses are to be conducted; (iii) licensed areas will be based on Statistics Canada census divisions; (iv) licensees

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[4] *Ibid*.

[5] For example, Industry Canada has auctioned off third generation PCS spectrum licenses and fixed 24 and 38 GHz spectrum licenses.

will be able to transfer and subdivide their licenses to eligible third parties; and (v) payments of winning bids will be required in a lump sum amount at the auction's close.

Therefore, although Canada, similar to the United States, introduced the potential allocation of spectrum licenses through an auction process, in contrast to the United States, Industry Canada requires a lump sum payment for a license allocated at auction. In addition, the BIA does not contain a provision similar to §525(a) of the United States Bankruptcy Code.[6]

As such, a strict reading of the *Nextwave* decision indicates that its impact on Canada may be minimal.

However, read broadly, the *Nextwave* decision may support a restructuring of a telecommunications company over the objection of a regulatory body, particularly if the restructuring involves licenses obtained at auction. As such, perhaps the *Nextwave* decision can support an argument that: (a) a licensee who is granted a license pursuant to an auction process obtains higher rights to the license than if the license had been awarded to it on, for example, a first come, first served basis; and (b) the transfer restrictions attached to the license should be relaxed as a result of the higher rights granted to the licensee (thereby allowing for a smoother transition during the restructuring process). Only time will tell the impact of the *Nextwave* decision in Canada and if our courts will endorse a broad reading of this decision.

B. Restrictions on Foreign Ownership

In Canada, telecommunications companies owned or controlled by non-Canadians are ineligible to operate as facilities-based carriers (i.e. carriers owning or operating their own transmission equipment, as opposed to switching and routing equipment), including local exchange carriers and long distance providers owning their own wires. The restrictions apply equally to wireless carriers providing terrestrial and satellite-based fixed and mobile, cellular and PCS services. However, the restrictions do not apply to resellers, including resellers that own their own switches.

In order to operate as a facilities-based carrier (technically referred to as a "telecommunications common carrier") or a wireless carrier (technically referred to as either a telecommunications common carrier or a "radiocommunications carrier"), the telecommunications company must be incorporated pursuant to the laws of Canada or one of its provinces and must meet the following requirements:

- not less than eighty per cent of the corporation's board of directors are individual Canadians; and

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[6] Although: (a) orders granted under the CCAA or in respect of a court-appointed receiver may contain provisions staying a person from revoking a license solely for non-payment by the debtor; and (b) upon the filing of a proposal or a notice of intention, the BIA prohibits any person from terminating a licensing agreement by reason of the non-payment of rent, royalties or other payments of a similar nature in respect of a period prior to the filing of the proposal or notice of intention.

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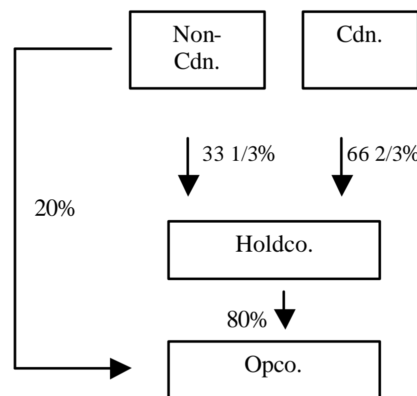
- Canadians beneficially own, directly or indirectly, in the aggregate and otherwise than by way of security only, not less than eighty per cent of all of the issued and outstanding voting shares of the corporation.

A higher level of foreign investment is permitted in the parent company of the telecommunications company. Such a parent must similarly be incorporated pursuant to the laws of Canada or one of its provinces, and Canadians must beneficially own, directly or indirectly, in the aggregate and otherwise than by way of security only, not less than sixty-six and two-thirds per cent of all of the issued and outstanding voting shares of the corporation.

Non-Canadian voting interests in the parent company (thirty-three and one-third per cent) and in the licensee or undertaking (twenty per cent) may be "stacked", so that the combined direct and indirect foreign interest may be as high as forty-six and two-thirds per cent.[7]



In addition to the above 'quantitative' restrictions on shareholdings and officers and directors, there is a 'qualitative' restriction on non-Canadians' controlling a telecommunications undertaking, whether directly or indirectly, through a parent or holding company. It must be stressed that when examining whether a non-Canadian exercises control, a very broad test for effective or *de facto* control is applied, which entails an examination of any personal, financial, contractual or business relation or any other consideration relevant to determining control. In this manner, it is ensured that non-Canadians do not exercise control in fact over a Canadian telecommunications undertaking, whether through control over its day-to-day operations or over its strategic direction.

As a result of the foreign ownership restrictions and the higher level of foreign investment allowed in the parent of a telecommunications company, the structure of most telecommunications undertakings involves a parent corporation and an operating entity. This structure leads to its own unique issues upon the insolvency of telecommunications companies.

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[7] You arrive at this number as follows: (a) 20% direct interest in Opco plus (b) 26.66% indirect interest in Opco via the Parent (which indirect interest is calculated by taking Holdco's 80% direct interest in Opco and multiplying this by the Parent's 33 1/3% interest in Holdco).

3. Structural Subordination

In the high tech boom, parties were lining up to invest in telecommunications companies, sometimes taking on additional risk in order to do so (which risk, at the time, seemed minimal). For example, it is not uncommon for much of the debt of a telecommunications undertaking to be found at the parent company level, with most of the assets at the operating company level. As a result, many investors may find themselves to be "structurally subordinated", meaning they may not have any input into the restructuring of the operating company and may receive nothing upon the completion of the operating company's restructuring.

A prime example of this structural subordination can be found upon an examination of the GT restructuring.

(a) GT

As mentioned previously, GT was granted protection in Canada pursuant to the CCAA, which protection, by virtue of an order granted under Section 304 of the U.S. Code, was recognized in the United States. In addition, GT's parent company assigned itself into bankruptcy.

In GT, the parent company issued U.S.$855,000,000 of senior discount notes under a trust indenture, which notes were unsecured obligations of the parent only. None of the operating companies guaranteed payment of the notes.

GT's plan of arrangement under the CCAA resulted from an intensive six-month process among GT and its stakeholders. The parent company was excluded from the plan of arrangement and the plan did not provide for any recovery for the holders of the notes. The plan received the approval of both classes of affected creditors and, despite last minute opposition from the trustee under the trust indenture, was sanctioned by the Ontario Superior Court of Justice. The trustee brought a motion before the Ontario Court of Appeal for leave to appeal, among other things, the Order sanctioning the plan. The trustee sought leave to appeal on the basis that the plan was not fair and reasonable, as it excluded the noteholders, the primary creditor of the parent company whose business was intertwined with the operating companies. The Ontario Court of Appeal refused to grant leave to appeal.

The GT case is reflective of the structural subordination issue that may arise upon an insolvency of a telecommunications undertaking, particularly in light of the foreign ownership restrictions.

PART V. CONCLUSION

The collapse of the high tech sector in late 2000 through 2001 continues to impact the telecommunications industry. The continued ripple effect will likely lead to additional insolvencies of telecommunications companies. Although an insolvency of a telecommunications company may be approached like an insolvency in any other industry, insolvency practitioners should be mindful of the unique issues which arise upon the collapse of a telecommunications company. Awareness of these unique issues will allow for a smoother and more efficient restructuring process, particularly in light of the cross-border component of most of these restructurings and the regulatory framework surrounding telecommunications companies.

SCHEDULE "A"
PART XIII OF THE *BANKRUPTCY AND INSOLVENCY ACT*

Part XIII — International Insolvencies

(a) Interpretation

267. Definitions — In this Part,

"debtor" means an 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;

"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, liquidator, administrator or receiver appointed by the court.

(b) General

268. (1) Presumption of insolvency — For the purposes 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 — Where a foreign proceeding has been commenced and a receiving order or assignment is made under this Act in respect of a debtor, the court may, on application and on such terms as 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 such property of the debtor outside Canada as 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.

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 — Where any receiving 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.

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"
SECTION 18.6 OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*

International Insolvencies

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.

(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.

(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.

(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.

(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.

(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.

(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.

(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.

SCHEDULE "C"
LEGISLATION IN CANADA PERTAINING TO THE TELECOMMUNICATIONS INDUSTRY

Telecommunications Legislation

- *Canadian Radio-television and Telecommunications Act*, R.S.C. 1985, c. C-22
- *Radiocommunication Act*, R.S.C. 1985, c. R-2
- *Telecommunications Act*, S.C. 1993, c.38
- *Teleglobe Canada Reorganization and Divestiture Act*, S.C. 1987, c. 12 (specified functions)
- *Telestat Canada Reorganization and Divesture Act*, S.C. 1991, c. 52

Marketplace and Trade Regulation

- *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3
- *Broadcasting Act*, S.C. 1991, c. 11
- *Canada Business Corporations Act*, R.S.C. 1985, c. C-44
- *Canada Corporations Act*, R.S.C. 1970, c. c-32
- *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36
- *Competition Act*, R.S.C. 1985, c. C-34
- *Government Corporations Operation Act*, R.S.C. 1985, c. G-4
- *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11 (Part 1 only)

Portfolio and Agency Legislation

- *Competition Tribunal Act*, R.S.C. 1985, c. 19 (2nd Supp.)

Largely Inactive or Minimal Involvement

Bell Canada Act, S.C. 1987, c. 19 (private act)