

INSOLVENCY GROUP NEWS

Equifax Canada's Newsletter prepared for Group members

Editorial

This is the introductory issue of *Insolvency Group News*. Those who join this group will receive nine editions each year. It is meant to address the concerns manufacturers and wholesalers have with bankruptcy legislation. We look forward to suggestions for material and comments about the articles that appear.

In 2002, the Bankruptcy and Insolvency Act comes up for review. You can choose to be or not to be part of this review process.

If you feel that because of the way the Bankruptcy and Insolvency Act is now written, your company has the potential to lose tens of thousands of dollars, then join us in changing this Act. We have to start this process immediately.

Equifax has formed an industry credit group to tackle the concerns that manufacturers and wholesalers have with this Act. The noted insolvency trustee and bankruptcy expert, Mel Zwaig, will assist in preparing and presenting proposals to the Superintendent of Bankruptcy.

By pooling the resources of hundreds of members, maximum impact can be gained while minimizing each member's costs in this lobbying effort. Group members will meet twice a year to voice their concerns and be updated on the progress being made. If you have not already joined the group, please fax us a note at 1 (800) 659-2942 and we will provide you with the details.

The Editor

EQUIFAX
CANADA

SUPPLIERS HAMMERED AGAIN

For unpaid suppliers, the improvement in their position that was promised in 1992 has failed to materialize

When the Bankruptcy and Insolvency Act (BIA) was amended in 1992, provisions were added to protect suppliers who had supplied goods to an insolvent business within 30 days of its bankruptcy or receivership. These provisions were intended to protect suppliers who sold a product to a business shortly before a receiver was appointed to liquidate the assets of the business, by allowing them (on certain conditions) to recover their goods. At the time, there was very little discussion or debate on whether these measures would be fair and effective, and there were many predictions that they wouldn't work.

The predictions have come true. The problem is with reorganizations. While the new legislation in 1992 extended the rights of unpaid suppliers, it more than extended the rights of reorganizing businesses. The two policies dramatically conflict.

Reorganizations under the BIA commonly feature interim receivers appointed to safeguard the interests of creditors. In several cases, unpaid suppliers have sought to exercise their

rights to reclaim unpaid-for merchandise when an "interim receiver" is appointed on the basis that this seems like a "receivership", which triggers their reclamation rights under the BIA. To date, they have lost badly. In the first case in point, an Ontario Court ruled that

The predictions have come true

an interim receiver in a reorganization under the BIA is not a "receiver" for purposes

of allowing unpaid suppliers to regain possession of their goods. A more recent case out of British Columbia has reached the same conclusion and extended the reasoning even further.

In the British Columbia case, the Court concluded that an interim receiver under the BIA could not fall within the definition of "receiver" and that the appointment was for purposes of a reorganization and not for purposes of liquidation. Consequently, the Court ruled that the rights of unpaid suppliers to reclaim their products did not arise. There are strong policy reasons on both sides of this issue; but for unpaid suppliers the improvement in their position that was promised in 1992 has failed to materialize, at least in reorganizations. ♦

Editorial Board

E. Bruce Leonard

Bruce Leonard is the partner in charge of the Business Reorganization Group at Cassels Brock & Blackwell and was admitted to practice in 1970.

Mr. Leonard is the Immediate Past Chair of the International Bar Association's Committee on Insolvency and Creditors' Rights (comprising 1,200 lawyers from over 80 countries). He is a Founding Member of and has been the Chair and a Director of The Insolvency Institute of Canada since its inception in 1990. He is a Past Chair of the Insolvency Law Section of the Canadian Bar Association (Ontario) and served as Vice-Chair of the International Bankruptcy Subcommittee of the American Bar Association's Business Bankruptcy Committee.

Mr. Leonard is a Member of the American Law Institute where he is the Chair and Co-Reporter for Canada on the American Law Institute's Transnational Insolvency Project. He served as the Co-Chair of the Government of Canada's Bankruptcy and Insolvency Committee Working Group on International Insolvencies and is a Member of the Ontario Court of Justice Chief Justice's Committee on Commercial Law Proceedings. Mr. Leonard is a Director of the American Bankruptcy Institute and is the Chair of the Trade and Finance Subcommittee of the ABI's International Committee. He is a Fellow of the American Bar Foundation, an international participant in the United States National Bankruptcy Conference and a Fellow of the American College of Bankruptcy. Mr. Leonard is Co-Director of the LL.M. Program in Insolvency Law at the Osgoode Hall Law School of York University, Canada's only graduate program in insolvency.

Mr. Leonard is the Co-editor of *Current Developments in International Insolvencies and Reorganizations* (Graham and Trotman: London, 1994), Co-editor of *Multinational Commercial Insolvency*, (American Bar Association: Chicago, 1993), and the author of *Guide*

The Fallen Sparrow

The deemed trusts created by the Income Tax Act will once again have priority over all types of security interests

For years, legal controversies ebbed and flowed over the relative priority of the deemed trust for unremitted income tax source deductions in a bankruptcy. The Supreme Court of Canada then ruled in *Sparrow Electric* that a security interest granted prior to the deemed trust being imposed would rank ahead of the deemed trust.

The Federal Government has the last word on these kinds of things; and by

way of response to the Supreme Court's decision, it amended the *Income Tax Act* to reverse the result of the case. The amendment was passed earlier this year but was made retroactive to June 15, 1994.

As a result of the amendments, the deemed trusts by the *Income Tax Act* will once again, with the exception of "prescribed security interests", have priority over all types of security interests. ♦

to *Commercial Insolvency in Canada* (Butterworths, 1988). Mr. Leonard is a Contributing Editor of *Norton Bankruptcy Law and Practice*, a Contributing Editor to the American Bankruptcy Institute *Journal* and a member of the Editorial Board of *Tolley's Insolvency Law and Practice* (London) and a frequent writer and speaker on international insolvency, creditors' remedies and secured transactions topics. ♦

Melvin C. Zwaig

Mel Zwaig is President of Zwaig Consulting Inc. and recently retired President of Arthur Andersen Inc. where he was the partner in charge of the Economic and Financial Consulting Practice.

Zwaig has been responsible for the development and implementation of the strategies on behalf of his clients in some of the major insolvencies in Canada such as, Abacus Cities, BCCI, Standard Rollins, American Sensors, Aerodat, Christian Brothers of Ireland, Eaton's and currently in Canadian Red Cross.

Zwaig was one of the original group of advisors who assisted in the establishment of the office of the Official Receiver in Montreal as well as the Commercial Crime Unit of the RCMP in

Montreal. In addition, Zwaig has been an advisor on Insolvency Legislation to the Senate Committee on Banking, Trade and Commerce, an advisor to the Ministry of Consumer and Corporate Affairs on proposed amendments to the Bankruptcy Act, an extension department lecturer at McGill University, a frequent speaker, lecturer and co-author. He is currently an Executive in Residence, School of Business, York University and a senior advisor to Hill & Knowlton.

Zwaig received a B.Comm. from Sir George Williams College, Montreal. He is a Trustee in Bankruptcy and a member of the Canadian, Quebec, Ontario and Alberta Institutes of Chartered Accountants, the Canadian Insolvency Practitioners Association, a founding member of the Insolvency Institute of Canada and an Associate International Member of the Institute of Certified Public Accountants of Israel. He is also a Certified Fraud Examiner, a member of the Turnaround Management Association and a member of the Association of Insolvency Accountants and a member of the Institute of Arbitration and Mediation.

Zwaig's current community involvement includes being a charter member of the Governing Council of St. Michael's Hospital, a member of the Board of Governors - Junior Achievement, Metropolitan Toronto; and Chairman of Seneca College Foundation. ♦

Legal History in a Cross-Border Reorganization

Once the dust settled, the company and its subsidiary were in reorganizational proceedings in the United States and in Canada at the same time

Legal history was recently made in a complex reorganizational proceeding between Canada and the United States. For the first time, a simultaneous joint hearing was held between a Canadian bankruptcy court and a United States bankruptcy court. The joint hearing was a highly successful response to a complex set of international issues which, but for the accommodating approaches taken by the Courts in both countries, would have led to a disastrous set of litigious proceedings that would have doomed the reorganizations.

The case involved a company headquartered in New Mexico with a subsidiary in Canada. The Canadian subsidiary was the primary owner of a major oil sands recovery project in Alberta. The parent company was listed on NASDAQ but encountered

financial difficulties in pursuing the development of its oil sands project in Alberta. When they encountered financial difficulties, the United States parent and the Canadian subsidiary both sought CCAA protection in Alberta.

Shortly thereafter, the parent company sought protection under Chapter 11 for both itself and its Canadian subsidiary in New Mexico. Consequently, while most of the creditors of the business were in the United States, most of the tangible assets were in Canada. Once the dust settled, the company and its subsidiary were in reorganizational proceedings in the United States and in Canada at the same time. Possibilities of endless litigation over complex insolvency and corporate governance issues in the case seemed limitless. For openers, stays of proceedings protected both companies in both countries, but the reorganizational

proceedings in each country arguably contravened the stays of proceedings in the other. The situation was ripe for an international conflict over which reorganization should have priority. The commercial solution to the financial difficulties of the companies involved a sale of a substantial portion of their interests in the Alberta oil sands project. Proceeding with a sale of the assets in Alberta, however, would almost certainly contravene the automatic stay under the U.S. Bankruptcy Code but, on the other hand, the Alberta Court unquestionably had

The case was a remarkable example of a close and constructive cooperation between the Canadian Court and the United States Court in a very complicated situation.

jurisdiction over the assets involved. A complete stand-off was a thoroughly feasible prospect.

After intense negotiation among the parties and with the encouragement of each of the Courts, simultaneous Court hearings were arranged for motions that were brought simultaneously in both Courts regarding the sale of the assets. The hearings took place in Bankruptcy Court in Albuquerque (where the parties to the Chapter 11 proceedings convened) and in Calgary (where the parties to the Canadian reorganization proceedings convened). The two hearings were connected by telephone conference call.

It was agreed that counsel in the United States proceedings would lead off with the presentation of their respective submissions in the joint hearing but that the United States Court would not rule on the motion before it until counsel



in the Canadian proceedings had made their submissions to the Canadian Court. Each Court invited counsel in the other proceedings to make submissions in both portions of the joint hearing. During the course of submissions, the Canadian judge and the United States judge exchanged comments regarding the resolution of the procedural and substantive issues that were being dealt with.

After submissions had been completed in Albuquerque and Calgary, both Courts granted comparable orders authorizing the sale of the companies' assets and ruling on the disposition of the proceeds. Both Courts encouraged the parties to negotiate and present a Cross-Border Insolvency Protocol for the management of the remainder of the one and issued other related procedural rulings to harmonize the progress of the two Cases.

The case was a remarkable example of a close and constructive cooperation between the Canadian Court and the United States Court in a very complicated situation. All of the parties benefited from this co-operation and the negotiations between the parties and the two-country reorganization were helped immeasurably by the accommodating approach that each Court took to the jurisdiction of the other. ♦

TO ATTORN ...OR NOT TO ATTORN

The BC Court found that the triple damages award did not offend public policy although no such scale of recovery is available in Canadian proceedings

When legal proceedings are commenced in another jurisdiction, one of the most pressing issues for a non-resident defendant is whether to attorn to the other jurisdiction, i.e. whether to defend the proceedings in the courts in the other jurisdiction. The decision of British Columbia Supreme Court in *Old North State Brewing Company Vs. Newlands Services* serves to illustrate the serious nature of the decision to attorn and the possible consequences of making the wrong decision.

In *Old North State*, the plaintiff sued in North Carolina for damages for breach of a contract for the supply and installation of brewing equipment. The contract between the plaintiff and the defendant provided that British Columbia law would apply and indicated that disputes would be litigated in British Columbia. Apparently, relying on these provisions, the defendant did

defend the North Carolina proceedings and the plaintiff obtained judgment against it. In the undefended proceedings, the North Carolina court held that the defendant's breaches of contract amounted to unfair trade practices and awarded triple damages under North Carolina law.

The plaintiff brought proceedings in BC to enforce the North Carolina judgment and the British Columbia court, in a summary proceeding granted judgment against the defendant. The Court concluded that North Carolina was the jurisdiction with the most substantial connection to the case because the equipment was delivered in North Carolina and the defendant was instrumental in installing the equipment there. The Court was not persuaded that the contract precluded proceedings in jurisdictions other than British Columbia, i.e., the clause providing for litigation to take place in BC did not provide the BC courts with exclusive

jurisdiction. The defendant contended that the North Carolina court should have, in accordance with the terms of the contract, applied BC law in determining damages, but British Columbia Court held that, in order to have had BC law applied, the defendant would have had to have appeared in the North Carolina proceedings and proved what the law in British Columbia was. Moreover, the BC Court found that the treble damages award did not offend public policy (although no such scale of recovery is available in Canada proceedings) and was therefore enforceable.

The *Old North State* decision drives home the importance of the decision whether or not to attorn to another jurisdiction. Non-residents who are sued in other jurisdictions must carefully consider whether they will attorn and must be aware of the risks associated with the decision not to attorn. ♦

New Liabilities for Directors: The Employment Insurance Act

The EIA has new provisions for regulatory penalties and offences which break entirely new ground

Directors of corporate employers are jointly and severally liable with the corporation for the payment of source deductions required under the EIA. Basically, in the same fashion as under the *Income Tax Act*, the Directors, of a corporation can be made liable where the government is unable to collect from the corporation through the normal enforcement process, or where the corporation is liquidated or becomes bankrupt. Directors are only liable for source deductions that should have been paid while they were directors, but there is no limit on the quantum of a director's personal liability.

Although the EIA's personal liability provisions follow the same pattern as the other federal and provincial statutes, the EIA has new provisions for regulatory penalties and offences which break

entirely new ground in the area of directors' liability. Under the EIA, the Employment Insurance Commission may now impose a financial penalty on a corporation. The penalty imposed by the Commission, of course, does not arise out of a trial, but is strictly administrative in nature. The EIA imposes a general personal liability on directors who are involved in the activities for which the penalties are prescribed. In addition to being directly liable for their own actions, however, directors are also liable for penalties imposed on the corporation where the corporation is unable to

pay the penalty itself, as a result of factors such as insolvency. This liability arises without any apparent concern in the legislation as to whether the directors actively participated in an activity or not and can be imposed even if the directors had no inkling that anything was wrong. Caveat directors. ♦

INSOLVENCY GROUP NEWS

Insolvency Group News is published by Equifax Canada as an information source to its Group members.

Comments and questions should be addressed to
Ian MacDonald at Equifax Canada
110 Sheppard Avenue East
Toronto, Ontario M2N 6S1
Telephone (416) 227-8551 Fax (416) 227-8769