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ASSET SALES UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*

(Thesis format: Monograph)

by

Alfonso S. Nocilla

Graduate Program in Law

2

A thesis submitted in partial fulfillment of the requirements for the degree of

Master of Laws

The School of Graduate and Postdoctoral Studies
The University of Western Ontario
London, Ontario, Canada

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THE UNIVERSITY OF WESTERN ONTARIO

School of Graduate and Postdoctoral Studies

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The thesis by

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Asset Sales Under the *Companies' Creditors* Arrangement *Act*

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ABSTRACT

This thesis examines the *Companies' Creditors Arrangement Act* (CCAA), the statute of choice in Canada for large, corporate restructurings. Specifically, this thesis asks whether it is appropriate to effect liquidations under the CCAA. The use of the CCAA to effect liquidations is controversial and raises fundamental questions about the purposes of restructuring. This thesis addresses the issue of liquidating CCAAs by examining the history, purpose and place of the CCAA within Canada's bankruptcy and insolvency regime. This analysis seeks to clarify the underlying policy objectives of the CCAA, taking into account modern restructuring theory, jurisprudence, and the 2009 amendments to the CCAA dealing with the court approval of asset sale plans. This analysis concludes by suggesting that counsel and the courts must consider carefully the "public interest" purpose of the CCAA that is often engaged in liquidations under the Act.

Keywords:

Bankruptcy and insolvency; restructuring; reorganization; liquidation; *Companies' Creditors Arrangement Act*

TABLE OF CONTENTS

CERTIFICATE OF EXAMINATION		ii
ABSTRACT		iii
TABLE OF CONTENTS		iv
INTRODUCTION		1
CHAPTER I	LEGISLATIVE HISTORY OF THE CCAA	6
CHAPTER II	THE PURPOSE OF THE CCAA	22
CHAPTER III	A THEORY OF RESTRUCTURING	40
CHAPTER IV	CCAA ASSET SALES AND SECTION 36	63
CHAPTER V	LIQUIDATING CCAAs	86
CONCLUSION		108
BIBLIOGRAPHY		110
CV		117

INTRODUCTION

This thesis focuses on the *Companies' Creditors Arrangement Act*[1] (CCAA), which has become the restructuring statute of choice in Canada for large corporations. A debtor company is considered insolvent when it is unable to pay its creditors.[2] Under the CCAA, an insolvent company with over $5 million in debt may apply for a court order staying the debt enforcement remedies of its creditors so that the company may attempt a compromise with its creditors to improve its financial situation.[3] This process is typically known as reorganization or restructuring.[4] A reorganization or restructuring may be contrasted with liquidation, in which the assets of the insolvent company are sold to satisfy the company's debts. Specifically, this thesis asks two questions:

1) Are liquidations appropriate under the CCAA?

2) If so, under what circumstances?

These are controversial questions because the CCAA historically was designed to facilitate the restructuring rather than the liquidation of insolvent companies. Recently, the British Columbia Court of Appeal in *Cliffs Over Maple Bay Investments Ltdv Fisgard Capital Corp* held that courts should not approve the use of CCAA proceedings by a debtor company to liquidate its assets where there is no restructuring plan.[5] Similarly, the Alberta Court of Appeal in *Royal Bank v Fracmaster Ltd* held that the sale of substantially all the assets of a debtor company generally is inconsistent with the purpose of the CCAA.[6] Despite these decisions, in the *Nortel Networks*[7] and *Canwest Global*[8]

[1] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36.
[2] Roderick J Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2009) at 16.
[3] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 s 3.
[4] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at para 12.
[5] *Cliffs Over Maple Bay Investments Ltd v Fisgard Capital Corp*, 2008 BCCA 327 at para 32.
[6] *Royal Bank v Fracmaster Ltd*, 11 CBR (4th) 230 (Alta CA) at para 16.
[7] *Re Nortel Networks Corp* (2009), 55 CBR (5th) 229 (Ont Sup Ct).

cases, Ontario courts approved applications to sell specific assets of the debtor companies before any restructuring plan was apparent. The different judicial approaches to CCAA liquidations have created controversy both within the courts and in the academic literature.[9] In a recent article, Blair J.A. of the Court of Appeal for Ontario summarized this controversy:[10]

> *Liquidation* under an Act designed to permit compromises that would *keep companies in business*! But court support for this practice can be traced as far back as Farley J.'s decision in *Re Lehndorff General Partner Ltd.* . . And the practice has become front and centre in more recent years. Indeed, the debate – crystallizing around Justice Tysoe's decision in *Cliffs Over Maple Bay* – is a live topic both here today and at yesterday's judicial colloquium.

The issue of CCAA liquidations raises questions about the basic purposes of the Act. This thesis addresses the issue by clarifying the underlying policy objectives of the CCAA, taking into account current restructuring theory and case law. This analysis leads to the conclusion that courts should approach CCAA liquidations with caution and give careful consideration to the broad constituency of potential stakeholders in corporate insolvencies. Liquidation under the CCAA may be appropriate in some cases, but only where this broader constituency of interests is better served through a CCAA process than through bankruptcy or receivership.

In *Century Services Inc v Canada (Attorney General)*,[11] the Supreme Court of Canada interpreted the provisions of the CCAA for the first time since the statute was enacted in 1933.In its decision, the Supreme Court offered the following guidance for interpreting the CCAA:[12]

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[8] *Re Canwest Global Communications Corp* 2009 CarswellOnt 7169 (Ont Sup Ct).
[9] See, for example, Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" (2008) *Annual Review of Insolvency Law* 33 at 44-45.
[10] Robert Blair, "The *CCAA* Over 30 Years: From Chrysalis to Butterfly or Chrysalis to Gadfly? Some Thoughts From an Appellate Perspective" [2010] Ann Rev of Insol L 557 at 563.
[11] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60.
[12] *Ibid* at para 16.

> In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence.

This thesis considers the origins, legislative history, policy objectives and case law of the CCAA as well as modern restructuring theory. This analysis provides the framework for discussing the issue of liquidation under the CCAA and for recommending solutions to the current controversy in the courts and in the literature.

Chapter I begins by examining the origins of the CCAA as a statute designed to enable the reorganization of insolvent companies so that they could avoid liquidation. Parliamentary debates and the historical context of Canada's bankruptcy system at the time of the CCAA's enactment in 1933 are examined. The chapter then traces the legislative history of the Act through various rounds of amendment from the 1950s until the most recent amendments in 2009. This includes an analysis of early case law as well as commentaries on the CCAA. The discussion in Chapter I provides the background for considering the purposes of the CCAA.

Chapter II considers interpretations of the purposes of the CCAA in the case law. Since the CCAA has no express purpose clause, judicial interpretation has played an important role in shaping the objectives and application of the statute. The case analysis in Chapter II builds on the discussion in Chapter I on early interpretations of the CCAA and seeks to provide a comprehensive account of the CCAA's basic purposes. Additionally, Chapter II sketches the boundaries of the controversy over CCAA liquidations. This discussion introduces some of the policy and theoretical issues that arise as a result of CCAA liquidations, which are discussed in detail in Chapter III.

Chapter III examines competing theories of restructuring in both Canada and the United States. A long running scholarly debate in the United States has created a rich

body of literature on the purposes and limits of restructuring. Chapter III considers these sources in analyzing the CCAA's place in the context of Canada's bankruptcy and insolvency system. In particular, this chapter explores the "public interest" purpose of the CCAA and the need for counsel and the courts to consider the interests of stakeholders other than traditional creditors in CCAA proceedings. This analysis also demonstrates how the liquidation debate raises fundamental questions about the purposes of the CCAA and develops a theoretical framework for answering these questions.

Chapter IV discusses the 2009 amendments to the CCAA that introduced a new provision, section 36, which deals specifically with the judicial approval of asset sales.[13] Chapter IV explains why section 36, in its present state, cannot adequately address the issue of CCAA liquidations. Far from adding clarity to the current judicial analysis of asset sales, as was intended, section 36 only adds to the confusion. Chapter IV also suggests possible changes to section 36 to correct this problem. This leads to the discussion in Chapter V on the liquidation vs. reorganization debate.

Chapter V examines the liquidation vs. reorganization debate in detail. This chapter considers both the case law and commentary on this issue and draws on the discussions in previous chapters of the CCAA's history, purpose and place in Canada's bankruptcy and insolvency system. Chapter V distinguishes between different types of liquidation under the CCAA – distinctions that are rarely made explicit in the case law – and demonstrates why these distinctions are important to the judicial analysis. This chapter argues that liquidations under the CCAA generally should be approached with caution, with some liquidation scenarios being more objectionable than others. This is because the CCAA is primarily a statute for the reorganization of insolvent companies

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[13] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 s 36.

and because the "public interest" purpose of the CCAA often is engaged in a liquidation scenario. This analysis also suggests how recent case law might cause a reassessment of the practice of allowing liquidations under the CCAA in Ontario, leading to a cautious approach that would be more consistent with that of courts in Alberta and British Columbia. This would be a welcome development as it would take into account a more robust version of the "public interest" purpose of the CCAA and lead to greater certainty in the sale approval process.

I. LEGISLATIVE HISTORY OF THE CCAA

(i) Introduction

The *Companies' Creditors Arrangement Act*[14](CCAA) has had a long and complicated history. The reform process has been slow. Recently, Parliament has introduced amendments in a manner that can only be described as hurried and incomplete, leaving it to the courts to determine how to apply the new provisions and to reconcile the changes with the body of CCAA law. Nonetheless, some salient points can be drawn from the CCAA's legislative history. The CCAA began and was intended as a statute for the reorganization and survival of insolvent companies. Moreover, this purpose is distinct from liquidation, which typically contemplates the end of the insolvent company. Since this is a controversial point, it is important to examine the origins and legislative history of the CCAA. A careful examination of this history illuminates the fundamental purpose of the statute: to facilitate the rehabilitation of the insolvent company.

(ii) Origins

TheCCAAhas its origins in the Great Depression. Enacted in 1933, the CCAA was introduced in order to provide a legal process by which insolvent companies could reorganize[15] themselves. At the time, federal bankruptcy legislation allowed

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[14] RSC 1985, c C-36.

[15] The term "reorganization" is not used in the legislation. However, as Duggan et al. explain, the term has become common in Canada and the United States to refer to the restructuring of the debts of an insolvent corporation. The CCAA refers only to an "arrangement", which generally is understood to mean an agreement between the company and its creditors to compromise the company's debt. Also, such agreements may involve the restructuring of the classes of creditors and equity holders of the debtor company. See Anthony J Duggan et al, *Canadian Bankruptcy and Insolvency Law: Cases, Text, and Materials*, 2nd ed (Toronto: Emond Montgomery, 2009) at 477, fn 1. This definition is consistent with Canadian courts' interpretation of the CCAA as legislation designed to allow companies to "avoid bankruptcy and continue as ongoing concerns through a reorganization of their financial obligations," see *Elan Corp v Comiskey* (1990), 1 CBR (3d) 101 (Ont CA). Likewise, it is generally understood that

reorganizations only for companies that were actually bankrupt. The Tassé Report[16] explains that Parliament amended *TheBankruptcy Act*[17] in 1923 to address complaints that debtors were bribing their creditors and using fraudulent means to obtain their creditors' consent for proposals in order to avoid bankruptcy.[18] The 1923 amendments introduced the requirements that a debtor be declared bankrupt and hold a first meeting of its creditors before a proposal could be made.[19] By 1933, the requirement that a debtor be declared bankrupt before a proposal could be made had met with sufficient criticism that Parliament introduced the CCAA, which provided an alternative for insolvent companies that wanted to reorganize.

The advent of the Great Depression necessitated legislation that enabled Canadian companies to reorganize. Prior to 1914, Canadian companies typically obtained financing in England. Under English law, a majority of debenture holders of a company could modify the terms of the company's trust deeds. This allowed Canadian companies with English financing to reorganize with the agreement of their creditors. However, during the 1920s, many Canadian companies began to obtain financing in the United States. In contrast to English law, it was uncommon for U.S. law to permit debenture holders to modify the terms of a company's trust deeds. Consequently, the trust deeds of Canadian companies that had obtained financing in the United States often contained no clauses allowing reorganization by agreement of the debenture holders.[20] When the

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reorganizations are required to have the co-operation of the debtor companies' creditors and shareholders, see *Re Avery Construction Co* (1942), 24 CBR 17 (Ont SC).

[16] House of Commons, Study Committee on Bankruptcy and Insolvency Legislation, *Report of the Study Committee on Bankruptcy and Insolvency Legislation* (June 1970) (Chair: Roger Tassé) [Tassé Report].

[17] 9-10 Geo V, Can S 1919, C 36.

[18] *Ibid* at 1.2.21. See also *The Bankruptcy Act Amendment Act, 1923*, 13-14 Geo V, Can S 1923, C 31.

[19] *Ibid.*

[20] Tassé Report, *supra* note 3 at 1.2.19. See also Duggan et al, *supra* note 2 at 15-22.

Depression forced many companies into insolvency, it was discovered that the terms of their trust deeds did not allow them to reorganize, "[often] to the embarrassment of the directors."[21] As a result, these insolvent companies were faced with bankruptcy.

(iii) Structure and Objectives

The CCAA was modeled on the provisions of the English *Companies Act of 1929*.[22] At the first reading of the CCAA in the House of Commons, the Hon. C.H. Cahan, then Secretary of State, explained that the legislation was intended to allow an insolvent company to avoid bankruptcy and to survive by reorganizing.[23] The Secretary explained that some method of reorganization was needed because of the large number of companies trying to reorganize as a result of the Depression:[24]

> At the present time, some legal method of making arrangements and compromises between creditors and companies is perhaps more necessary because of the prevailing commercial and industrial depression and it was thought by the government that we should adopt some method whereby compromises might be carried into effect under the supervision of the court without utterly destroying the company or its organization without loss of good will and without forcing the improvident sales of its assets.

The economic context of the CCAA's enactment during the Depression is significant. In his seminal article "Reorganizations Under the Companies' Creditors Arrangement Act",[25] Stanley Edwards reiterated the Hon. C.H. Cahan's remarks on the CCAA and emphasized the legislation's importance in providing a reorganization procedure for companies to continue as "ongoing concerns"[26] in the event of future economic downturns.[27]

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[21] *Ibid.*
[22] *Ibid* at 1.2.21. See also Duggan et al, *supra* note 2 at 478.
[23] *House of Commons Debates,* 17th Parliament, 4th Session, Vol 4 (1933) at 4090 (Hon CH Cahan).
[24] *Ibid.*
[25] Stanley E Edwards, (1947) 25 Can Bar Rev 587.
[26] In other words, to emerge from insolvency and continue functioning as a business without the threat of liquidation.
[27] *Ibid* at 590.

Initially, the CCAA was intended to facilitate arrangements between companies and their secured creditors only.[28] Secured creditors were protected both by the legislation itself and by the terms of most trust deeds, which gave indenture trustees the right to intervene in the debtor's affairs on certain conditions.[29] Institutional investors also had the power to intervene to prevent serious abuses. However, unsecured creditors lacked the protections available to them in the *Bankruptcy Act*, resulting in abuses that led to significant reforms of the CCAA in 1953.

(iv) Early Reform Attempts

In the years following its enactment, some insolvent companies began using the CCAA to make arrangements with their unsecured creditors as an alternative to using the *Bankruptcy Act*. Since the CCAA lacked the proper procedure for such arrangements, unsecured creditors were left vulnerable to insolvent companies making false and misleading statements to induce acceptance of unfair proposals.[30] Trade creditors were particularly upset that debtor companies were using the CCAA to escape their mercantile liabilities.[31] Consequently, in 1938, Parliament considered repealing the CCAA.[32] However, the Dominion Mortgage and Investment Association strongly opposed the repeal of the CCAA, chiefly because U.S. law prohibited the sale of securities that did not have associated legislation enabling holders of those securities to effect a reorganization of the company.[33] Since the CCAA was the only statute by which Canadian companies could reorganize, this would make it impossible for these companies to obtain financing

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[28] Tassé Report, *supra* note 3 at 1.2.23.
[29] *Ibid* at 1.2.24.
[30] *Ibid* at 1.2.23.
[31] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: Thomson Carswell, 2007) at 14.
[32] *Ibid.*
[33] *House of Commons Debates*, 21st Parl, 7th Sess, Vol 2 (1952-1953) at 1269.

in the United States, or for security holders of these companies to sell their securities in the United States. Plans to repeal the CCAA were stalled while debates about the debtor company's control over the reorganization process continued for several years.[34]

In 1946, new efforts at reform led to Bill A5, which proposed to repeal the CCAA and to bring all corporate reorganizations under the *Bankruptcy Act*.[35] However, Bill A5 contained no provisions to address the situation of investor creditors. In particular, no provision was made for representation orders – allowing groups of creditors to be represented in reorganization proceedings – and the legislation required that service be made on all creditors, which was often impossible.[36] Once again, the Dominion Mortgage and Investments Association opposed the repeal of the CCAA, instead suggesting amendments that would restrict the CCAA's application to proposed arrangements that affected a debtor company's outstanding issue of bonds or debentures as a way of addressing the concerns of unsecured creditors.[37] While the *Bankruptcy Act* was amended in 1949,[38] plans to repeal the CCAA were abandoned. Notably, the new *Bankruptcy Act* contained provisions allowing an insolvent person to make a proposal without being bankrupt.[39]

(v) 1953 Amendments

Following several years of intermittent debate, Parliament enacted amendments to the CCAA in 1953 according to the recommendations of the Dominion Mortgage and Investments Association. The CCAA's application was restricted to a debtor company

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[34] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: Thomson Carswell, 2007) at 14.
[35] Senator Fogo outlined these amendments, contained in Bill A5, during debates preceding the *Bankruptcy Act* of 1949. *Debates of the Senate*, 21st Parl, 2nd Sess (1949) at 97 (Hon James Gordon Fogo).
[36] Tassé Report, *supra* note 3 at 1.2.25.
[37] *Ibid* at 1.2.26.
[38] *Bankruptcy Act, 1949,* 13 Geo VI, Can S 1949 (2nd Sess), C 7.
[39] *Debates of the Senate*, 21st Parl, 2nd Sess (1949) at 97 (Hon James Gordon Fogo).

with an outstanding debenture issue that wanted to make a proposal to its debenture holders.[40] These amendments reinforced the intentions of the original drafters of the CCAA to facilitate arrangements between insolvent companies and their secured creditors. The Hon. Stuart S. Garson, then Minister of Justice, explained:[41]

> The *Companies' Creditors Arrangement Act* was passed in 1933. At that time, the *Bankruptcy Act* did not contain adequate provisions for an arrangement between a corporate debtor and its creditors by which the corporate debtor, by getting an extension of its liabilities, could liquidate them, avoid bankruptcy and retain its identity. . . The *Companies' Creditors Arrangement Act* was passed to enable these corporate debtors to make an extension of that sort without going into bankruptcy.

The Minister further stated that both trade creditors and investor creditors had approved of the 1953 amendments, and that the new bill would "leave companies that have complex financial structures…able to use the *Companies' Creditors Arrangement Act* for the purpose of reorganization."[42]

Following these amendments, the CCAA fell into disuse for over thirty years. Writing in 1970, the Tassé Committee explained that the CCAA had worked well in its early years and "gave general satisfaction to investors and companies with secured indebtedness who wished to make arrangements with their creditors."[43] However, the CCAA became far less popular after its use was restricted in 1953. Moreover, by 1970, it had become common for trust indentures to include terms permitting the contractual reorganization of the debtor company without recourse to the CCAA.[44]

(vi) The Tassé Committee

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[40] *An Act to Amend the Companies' Creditors Arrangement Act, 1933*, 1-2 El II, Can S 1952-53, C 3.
[41] *House of Commons Debates*, 21st Parl, 7th Sess, Vol 2 (1952-1953) at 1269.
[42] *Ibid.*
[43] Tassé Report, *supra* note 3 at 1.2.23.
[44] *Ibid* at 1.2.28.

Criticism of the 1949 *Bankruptcy Act* as obsolete, inefficient, and unable to cope with fraudulent bankruptcies led to a new round of reforms in 1966.[45] With *AnAct to Amend the Bankruptcy Act*,[46] Parliament introduced amendments granting the court the right to appoint an interim receiver and providing that an insolvent person would be assigned into bankruptcy if the creditors or the court refused to approve the proposal.[47] At the same time, the federal government also formed the Study Committee on Bankruptcy and Insolvency Legislation (Tassé Committee) and commissioned a report recommending further changes to Canada's bankruptcy regime. The Tassé Committee presented its report to the Minister of Consumer and Corporate Affairs in June 1970.[48]

Among its many recommendations for reforming Canada's bankruptcy and insolvency regime, the Tassé Report suggested repealing the CCAA and including a procedure for reorganizing insolvent companies in a new, integrated bankruptcy and insolvency statute.[49] However, Parliament did not implement this recommendation. In fact, six bankruptcy bills were unsuccessfully introduced into Parliament between 1970 and 1984, with each attempt failing to bring about the intended "sweeping reform of the bankruptcy system."[50] In particular, the federal government found it difficult to respond to the intense lobbying of numerous competing special interest groups.[51] Pressure from these groups increased following many business collapses during the recession in the 1980s. At the same time, the government lacked sufficient information, in the form of

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[45] House of Commons, Advisory Committee on Bankruptcy and Insolvency, *Report of the Advisory Committee on Bankruptcy and Insolvency* (January 1986) (Chair: Gary F Colter) [Colter Report] at 18.
[46] 14-15 El II, Can S 1966-67, C 32.
[47] *Ibid*, ss 7 and 8.
[48] Tassé Report, *supra* note 3.
[49] *Ibid* at 81.
[50] Colter Report, *supra* note 32 at 18.
[51] Jacob S Ziegel, "The Travails of Bill C-12" (1983-1984) 8 CBLJ 374 at 375.

legal and economic studies, to formulate policy.[52] Consequently, the government adopted an approach that Jacob Ziegel has called a "phased-in program of reform".[53] Rather than pursue a "single massive overhaul" of insolvency legislation, subsequent governments have favoured piecemeal reform.[54] As discussed below, this phased-in program of reform ultimately led to the development of Canada's bifurcated system for business reorganizations.[55]

(vii) The Colter Committee

Following the string of failures to enact a new, comprehensive bankruptcy statute, the federal government determined that a more modest reform effort might succeed. The Minister of Consumer and Corporate Affairs convened the Advisory Committee on Bankruptcy and Insolvency (Colter Committee) to recommend the most urgent amendments to the existing legislation.[56] Meanwhile, the government proceeded with a consolidation of the *Bankruptcy Act*, leading to passage of the *Bankruptcy and Insolvency Act* (BIA) in 1985.[57]

The Colter Committee completed its report in 1986, and the government largely adopted its recommendations in the 1992 amendments to the BIA. Among these changes to the BIA were: increased protections for wage earners,[58] changes to the proposal procedures to stay secured creditors,[59] and new provisions dealing with international

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[52] *Ibid.*

[53] Jacob S Ziegel, "Canada's Phased-In Bankruptcy Law Reform" (1996) 70 Am Bankr LJ 383 at 383.

[54] Jacob S Zeigel, "The Modernization of Canada's Bankruptcy Law in a Comparative Context" (1999) 4 CBR (4th) 151 at 151.

[55] For a summary of Professor Ziegel's articles and concerns about the reform process, see Thomas GW Telfer, "Canadian Insolvency Law Reform and 'Our Bankrupt Legislative Process'" [2010] Ann Rev of Insol Law 583.

[56] *Ibid.*

[57] *Bankruptcy and Insolvency Act*RSC1985cB3[as amended25c47]

[58] Colter Report, *supra* note 32 at 21.

[59] *Ibid* at 56.

insolvencies.[60] These amendments addressed some of the most pressing concerns of the Colter Committee and brought the BIA up to date, but they did not deal with the issue of CCAA and BIA integration.

Significantly, the Colter Report did not revive the Tassé Report's earlier recommendation to repeal the CCAA. By 1986, after years of relative obscurity, the CCAA came into use again as a mechanism for facilitating large corporate reorganizations. In the period between 1986 and 1992, Canadian courts employed the CCAA's skeletal provisions to creatively and successfully reorganize many medium and large sized corporations. In 1992, the House of Commons Committee examining Bill C-22[61] recommended repealing the CCAA within three years following the enactment of new provisions for business reorganizations in Part III.1 of the BIA.[62] However, many insolvency practitioners opposed the repeal of the CCAA, as they had come to favour the more flexible reorganization process in the CCAA over that in Part III.1 of the BIA.[63] The government decided not to repeal the CCAA until the new reorganization provisions in the BIA had been tested.[64]

(viii) The 1997 Amendments

In 1993, Industry Canada established the Bankruptcy and Insolvency Act Advisory Committee (BIAC) to recommend amendments to the BIA. The federal government adopted many of the Committee's recommendations in Bill C-5, amending

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[60] *Ibid* at 99.

[61] Bill C-22, 34th Parl, 3rd Sess (1991). This amending act became law in 1992 as the *Bankruptcy and Insolvency Act*, RSC 1992, c C-27.

[62] House of Commons, Standing Committee on Consumer and Corporate Affairs and Government Operations, "Minutes of Proceedings and Evidence", "Pre-Study of Bill C-22" in *Official Report of Debates (Hansard)*, No 15 (7 October 1991) at 14.

[63] Duggan et al, *supra* note 2 at 478.

[64] Jacob S Ziegel, "Canada's Phased-In Bankruptcy Law Reform" (1996) 70 Am Bankr LJ 383.

both the BIA and the CCAA in 1997.[65] As they had done in 1992, insolvency practitioners successfully opposed the CCAA's repeal on the grounds that it provided the necessary flexibility for large, complex reorganizations.[66]

Among the more important changes introduced to the CCAA in 1997 were: new provisions restricting the CCAA's application to corporate debtors with at least $5 million in debt; removal of the requirement in s. 3 for an outstanding issue of debentures or bonds and a trust deed in order to use the CCAA; new requirements for a court-appointed monitor to protect creditors' interests and report to the court while the debtor prepares a plan for the creditors to vote on; and provisions recognizing foreign insolvencies and allowing Canadian courts to assist foreign insolvency administrators.[67] Far from providing for the repeal of the CCAA, these amendments reinvigorated the CCAA and firmly established a bifurcated system for business reorganizations in Canada.[68]

(ix) Industry Canada Report (2002)

The 1997 amendments contemplated further changes to Canadian bankruptcy laws in the future. Importantly, the federal government was required to report to Parliament on the operation of the BIA and CCAA within 5 years. In 2002, Industry Canada published its *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*.[69] In this report, Industry Canada cautioned that while the 1997 amendments had introduced substantive changes, they fell short of comprehensive reforms, and many issues remained to be addressed.

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[65] Bill C-5, SC 1997, c 12.
[66] Jacob S Ziegel, "Canada's Phased-In Bankruptcy Law Reform" (1996) 70 Am Bankr LJ 383 at 397.
[67] *Ibid.* See also Duggan et al, *supra* note 2 at 18 for further discussion of these amendments.
[68] Jacob S Ziegel, "Canada's Phased-In Bankruptcy Law Reform" (1996) 70 Am Bankr LJ 383 at 396.
[69] Industr y Canada, Marketplace Framework Policy Branch, Policy Sector (Ottawa: Industry Canada, 2002).

Specifically, the report cited the problem that CCAA reorganizations were not subject to an administrative supervision process:[70]

> [It is] practically impossible to assess procedures under the CCAA or to verify whether services are being performed properly...to measure the effectiveness of the reorganization schemes or to verify whether they are being applied and administered consistently.

Additionally, the absence of a centralized public database of CCAA reorganizations made it very difficult "to determine which companies use the CCAA in a given year... [and] to ascertain their profiles or how successful their reorganization processes were."[71] The report further warned that there were no formal qualification requirements or rules of professional conduct for CCAA monitors and that many stakeholders had expressed concerns about the "numerous potential conflicts of interest [monitors] might face, especially if they are acting in various other capacities for the debtor company."[72] Stakeholders estimated at the time that the CCAA was used in "upwards of 50 cases a year, with a typical case involving in excess of $100 million in assets."[73] However, without concrete data, the report concluded that it was "impossible to measure the impact of the CCAA's use on the Canadian economy."[74]

(x) Senate Committee Report (2003) and Bills C-55 and C-62

The Senate Committee on Banking, Trade and Commerce was charged with reviewing the BIA and CCAA in accordance with the requirements of the 1997 amendments. Its 2003 report, entitled *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors*

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[70] *Ibid* at 18.
[71] *Ibid* at 19.
[72] *Ibid.*
[73] *Ibid* at 40.
[74] *Ibid.* The report suggested the implementation of several changes to increase the transparency of the CCAA reorganization process, such as: the establishment of a national public registry, mechanisms for addressing complaints, and requirements for monitors. However, no specific legislative proposals were made.

Arrangement Act,[75] contained 34 recommendations related to commercial insolvency law. In June of 2005, the government introduced Bill C-55, which proposed to implement most of the Senate committee's recommendations. Unfortunately, the bill was widely criticized for its hurried drafting and was rushed through Parliament without debate in the final days of the Martin government in 2005.[76] The Senate Committee also expressed its disappointment with the House's treatment of the Bill, stating:[77]

> We recognize the extraordinary circumstances that exist with the impending dissolution of Parliament, but believe we had an inadequate opportunity to review comprehensively such an important piece of framework legislation.

The Senate agreed to pass Bill C-55 with the understanding that the government would delay proclamation until the bill's shortcomings could be addressed with additional revisions. Upon enactment, Bill C-55 became Chapter 47 of the Statutes of Canada.[78]

Revisions came in June of 2007, when the new Harper government tabled Bill C-62.[79] Although the House passed Bill C-62, it died on the Order Paper when Parliament was prorogued on September 14, 2007. It was reintroduced later as Bill C-12, which the House passed on October 27 of the same year, and was referred to the Senate Committee

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[75] Senate, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) (Chair: Richard H Kroft) [Senate Committee Report].

[76] Stephanie Ben-Ishai & Anthony Duggan, *Canadian Bankruptcy and Insolvency Law: Bill C-55, Statute c. 47 and Beyond,* (Markham: LexisNexis, 2007) at 5. The authors also cite, among others, Insolvency Institute of Canada (IIC), News Release, "Insolvency Experts Say Proposed Legislation is Flawed" (17 November 2005), online: <http://www.insolvency.ca/papers/Bill%20C-55%20Press%20Release%20for%20IIC_final-Nov17.pdf>; IIC, *Position Paper on Bill C-55* (12 October 2005), online: <http://www.insolvency.ca/papers/IIC%20Position%20Paper%20re%20Bill%20C-55_Oct%2012.pdf>.

[77] Senate Standing Committee on Banking, Trade and Commerce, "Seventeenth Report" in *Official Report of Debates (Hansard)*, (24 November 2005).

[78] Ben-Ishai and Duggan, *supra* note 60 at 6.

[79] *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, 13 June 2007.

on Banking, Trade and Commerce on November 15.[80] Following enactment it became Chapter 36[81] and its provisions came into effect, at last, on September 18, 2009.

Together, Bill C-55 and Bill C-12 introduced notable changes to both the BIA and the CCAA, including: provision for employee wages and pension payments before a court can approve a CCAA plan, provision for the assignment and disclaimer of leases in the BIA and CCAA, codification of interim or debtor-in-possession (DIP) financing procedures, and new cross-border insolvency provisions introducing a modified version of the UNCITRAL Model Law on Cross-Border Insolvency.[82]

Most importantly for the purposes of this paper, Parliament also amended the CCAA to introduce provisions governing the court approval of asset sales.[83] The new section 36 seems to permit not only reorganizations, but also liquidations in which the debtor company ceases to exist. This is surprising in light of the discussion of the CCAA's history thus far – in fact, there is nothing in its legislative history until recently to suggest that the CCAA might be used to effect wholesale liquidations of companies. Interpreting the CCAA's provisions for the first time in *Reference re Companies' Creditors Arrangement Act*,[84] the Supreme Court of Canada never contemplated that the CCAA would be used for anything but reorganization.[85] More recently, in *Century*

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[80] "Background" of Bill C-12: An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005, Parliament of Canada Virtual Library, Law and Government Division, 14 December 2007. Online: <http://www2.parl.gc.ca/Sites/LOP/LegislativeSummaries/Bills_ls.asp?lang=E&ls=c12&source=library_prb&Parl=39&Ses=2>.

[81] *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, 39th Parl, 1st Sess (27 October 2007).

[82] United Nations Commission on International Trade Law, *Model Law on Cross-Border Insolvency*, GA Res 52/158, arts 25-27, UN Doc A/Res/52/158 (Jan 30, 1998).

[83] S 36.

[84] [1934] SCR 659.

[85] *Ibid* at para 4.

ServicesInc. v. Canada (Attorney General),[86] the Supreme Court reaffirmed this interpretation of the CCAA's basic purpose:[87]

> The purpose of the CCAA – Canada's first reorganization statute – is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets.

(xi) Recent Developments

In order to understand the CCAA's evolution and its significance in Canada's bankruptcy and insolvency regime, it is useful to consider some data on the number of CCAA cases. In a 2006 report to the Office of the Superintendent of Bankruptcy Canada (OSB), Janis Sarra presented a model to track filings and collect data on CCAA proceedings.[88] Previously, Industry Canada had estimated that there were about 175 total cases under the CCAA between 1983 and 2005. Sarra's study identified 219 cases in those years. By contrast, there are only 7 known CCAA cases prior to 1983, all from the early years of the Act before it fell into disuse for roughly forty years.[89]

Since the mid-1980s, the CCAA has become the restructuring statute of choice in Canada. Also, data on the number of CCAA filings in recent years show that the rate of filings is increasing. Although there is no comprehensive database of all CCAA cases, the OSB has recorded all companies granted CCAA protection since September 18, 2009. As of June 6, 2011, the OSB reports that over 60 companies have been granted CCAA

[86] 2010 SCC 60.
[87] *Ibid* at para 15. See also paras 14 and 23.
[88] Janis Sarra, *Development of a Model to Track Filings and Collect Data for Proceedings under the CCAA*, Final Report to the Office of the Superintendent of Bankruptcy (March 2006). Online: <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01669.html>
[89] Janis Sarra, "The Evolution of the Companies' Creditors Arrangement Act in Light of Recent Developments" forthcoming in (2011) 50 CBLJ.

protection.[90] This is a significant increase in the rate of filings from the 219 cases recorded between 1983 and 2005 in Janis Sarra's study.

Perhaps the most cited reason for the CCAA's popularity is its flexibility and the broad discretion that it grants to the supervising judge. In *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp*,[91] the Ontario Court of Appeal stated:

> It is beyond controversy, however, that the *CCAA* is remedial legislation to be liberally construed. . . It is designed to be a flexible instrument and it is that very flexibility which gives the Act its efficacy.

This flexibility and broad judicial discretion has had a profound impact on the CCAA's evolution. The academic literature often refers to the "skeletal nature" of the legislation.[92] The CCAA has been called a "relatively short, bare statute."[93] In many ways, then, the history of the CCAA is a history of courts "fleshing out" the bare-bones provisions of the Act. The CCAA has flourished in these circumstances, its flexibility leading to its use in the largest, most complex Canadian restructurings of the last 25 years. Given the importance of judicial interpretation to the CCAA's development, it is perhaps unsurprising that many of the recent amendments to the Act are regarded largely as codifications of practices already well established in the courts.[94]

(xii) Conclusion

An examination of the CCAA's origins and legislative history shows that the CCAA began as a statute intended to facilitate reorganizations rather than liquidations. This emphasis on reorganization and the survival of the debtor company is evident not

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[90] Online: <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br02281.html#Chronological>

[91] 2008 ONCA 587 (Ont CA), leave to appeal refused. See also Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" [2008] Ann Rev Insol L 33.

[92] Among others, see Sarra, *supra* note 72. See also Fitzpatrick, *supra* at 44.

[93] Bill Kaplan, "Liquidating CCAAs: Discretion Gone Awry?" [2008] Annual Rev Insol L at 79.

[94] For example, see *Re SemCanada Crude Co* (2009), ABQB 490 at para 44, in which the court states that the 2009 amendments to the CCAA do not change in any material way the factors already established in the case law for approval of a classification for voting purposes. See also para.16, in which the court explains that these factors were developed over time in the case law and in the absence of statutory guidance.

only in the Parliamentary records when the CCAA was introduced, but also in the early commentaries and the Supreme Court jurisprudence on the Act. However, the CCAA's flexibility and its frequent use in recent years has led to the development of a rich body of case law interpreting the Act.[95] The detailed history of the CCAA in this chapter provides a crucial backdrop for examining this case law, particularly on the issue of whether courts should allow liquidations under the Act. This will be discussed in Chapter II.

[95] See, for example, Farley J.'s statement that "[t]he history of CCAA law has been an evolution of judicial interpretation", *Re Dylex Ltd* (1995), 3 CBR (3d) 106 at 111 (Ont Gen Div).

II. THE PURPOSE OF THE CCAA

(i) Introduction

The CCAA has no express purpose clause. Only its long title, "An Act to facilitate compromises and arrangements between companies and their creditors," gives some indication of Parliament's purpose in enacting it, while section 3 specifies that the Act applies only to insolvent companies with over $5 million in debt.[96] With this general goal in mind, it has been left to the courts to determine much of the CCAA's application and specific powers.

It is often observed that the CCAA is "a skeleton piece of legislation" that the courts have fleshed out over time.[97] While judicial interpretation has played a key role in the CCAA's development, it is important to recall that the CCAA began its life as a Depression-era statute intended to facilitate the reorganization and survival of insolvent companies, so as to avoid the negative social and economic consequences of bankruptcy.[98] In interpreting the CCAA over time, courts have given careful consideration to these origins and the remedial purposes of the legislation. At the same time, while the CCAA is a federal statute, there has been variation in the way the courts of the different provinces have interpreted and applied it with respect to liquidations. This chapter will provide an overview of some of the leading decisions interpreting the scope, powers and purpose of the CCAA. It will go on to examine the divergence in judicial interpretations with respect to liquidations under the CCAA.

(ii) Early Interpretations of the Act

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[96] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 s 3.
[97] *Re Dylex Ltd* (1995), 31 CBR (3d) 106 at para 10 (Ont Gen Div).
[98] *House of Commons Debates,* 17th Parl, 4th Sess, Vol 4 (1933) at 4090 (Hon CH Cahan). See also Stanley E Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) 25 Can Bar Rev 587.

The CCAA itself contains little guidance as to Parliament's intent or how the legislation should be interpreted. Although it was enacted in 1933, the CCAA has spent most of its life in obscurity, only emerging as the restructuring statute of choice in Canada in the 1980s.[99] As such, there is little in the way of guidance on how to interpret the CCAA from cases before 1980. However, a few early cases and scholarly commentaries offer some insight into the objectives of the legislation.

In *Reference re Companies' Creditors Arrangement Act*,[100] the Attorneys-General for Québec and Ontario asked the Supreme Court of Canada whether the CCAA was constitutionally valid legislation. The year was 1934, shortly after Parliament had enacted the legislation, and it was one of the few times that the Supreme Court has considered the CCAA's purpose.[101] In its decision, the Court unanimously upheld the legislation as a proper exercise of Parliament's power under sec. 91(21) of the *British North America Act*[102] in the field of bankruptcy and insolvency. The justices understood the CCAA to be a statute dealing with "compositions and arrangements" and called it "a proper component of a system of bankruptcy and insolvency law" that co-existed with, but was separate from, other bankruptcy legislation at the time. With regards to the basic purpose of the CCAA, Duff C.J.C., stated:[103]

> [T]he aim of the Act is to deal with the existing condition of insolvency in itself to enable

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[99] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at para 19.

[100] [1934] SCR 659.

[101] Many years later, on a procedural motion in *Re* Westar *Mining Ltd,* [1993] 2 SCR 448, the Supreme Court held that it had the jurisdiction to hear appeals in CCAA cases. On December 16, 2010, the Supreme Court released its reasons for decision in *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60. This is the first case in which the Supreme Court has considered the CCAA's purpose since 1934. Later in 2011, the Supreme Court is expected to hear the appeal of *Re AbitibiBowater Inc,* 2010 QCCS 1742 (Que Sup Ct), in which the paramountcy of the federal regime under the CCAA will again be pitted against provincial legislation, this time in the form of provincial fines for environmental damage against a company undergoing CCAA restructuring.

[102] *The Constitution Act, 1867* (UK), 30 & 31 Victoria, c 3. This is now the *Constitution Act, 1982*, Schedule B, *Canada Act 1982*, c 11 (UK) [RSC, 1985, Appendix II, No 44].

[103] *Reference re Companies' Creditors Arrangement Act* [1934] SCR 659 at paras 4 and 7.

> arrangements to be made in view of the insolvent condition of the company under judicial authority which, otherwise, might not be valid prior to the initiation of proceedings in bankruptcy.
>
> [...]
>
> The ultimate purpose would appear to be to enable the Court to sanction a compromise which, although binding upon a class of creditors only, would be beneficial to the general body of creditors as well, it may be, as to the shareholders.

In concurring but separate reasons, Cannon and Lamont JJ. also reflected on the nature and purpose of the legislation:[104]

> [i]f the proceedings under this new Act of 1933 are not, strictly speaking, "bankruptcy" proceedings, because they had not for object the sale and division of the assets of the debtor, they may, however, be considered as "insolvency proceedings" *with the object of preventing a declaration of bankruptcy and the sale of these assets*, if the creditors directly interested for the time being reach the conclusion that an opportune arrangement to avoid such sale would better protect their interest, as a whole or in part.

The above statements are significant because of the clear distinction they draw between the bankruptcy regime, which deals with liquidation, and the CCAA, which is an insolvency statute intended to facilitate the survival of an insolvent company. Bankruptcy deals with the distribution of the property of a bankrupt – an "insolvent person"[105] who has committed an act of bankruptcy – among his creditors. On the other hand, the CCAA deals with insolvency proceedings that seek to prevent a bankruptcy and the sale of these assets.[106] At the same time, these statements in *Re CCAA* take a narrow interpretation on a possible "public interest" purpose for the statute. That is, the Supreme Court in *Re CCAA* makes no mention of the public interest in preventing the negative social and economic consequences of corporate failure, such as the loss of jobs or of valuable goods and services. The reason for this narrow reading of the CCAA's purpose may be that *Re CCAA* was primarily concerned with constitutional interpretation rather

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[104] *Reference re Companies' Creditors Arrangement Act*, [1934] SCR 659 at para 17 (emphasis added).
[105] Including an insolvent corporation, see *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 s 2.
[106] *Reference re Companies' Creditors Arrangement Act*, [1934] SCR 659 at paras 16-17.

than interpretation of the statute itself. Nonetheless, as will be discussed below, the public interest is an important consideration under the CCAA.

In the seminal 1947 article "Reorganizations Under The Companies' Creditors Arrangement Act,"[107] Stanley Edwards discussed in detail the CCAA and the various considerations that arise in reorganizations. Broadly, Edwards saw the underlying purpose of the CCAA being to protect an insolvent company so that it could reorganize, survive and avoid the negative consequences of liquidation.[108] Restructuring under the CCAA might be more beneficial to a company and its stakeholders than liquidation for several reasons: the going concern value of the company might be greater than the liquidation value of its individual business units; the value of the company's reputation and relationships with customers and suppliers might be lost on liquidation; various other intangible assets might be lost on liquidation; and it might be difficult to find a buyer willing to pay the company's going concern value in a liquidation.[109] For example, Edwards suggested that it would be difficult to sell a very large company on a going concern basis to a single purchaser. It may be equally difficult for companies to sell specific assets in industries with very few potential buyers, particularly in depressed industries.

Edwards emphasized the importance of both the purpose of the CCAA and "several fundamental principles which may serve to accomplish that purpose."[110] Certainly, one aim of reorganization was to benefit creditors in situations where they would otherwise realize little or no satisfaction of their interests through liquidation. But

[107] (1947) 25 Can Bar Rev 587.
[108] *Ibid* at 592.
[109] *Ibid.*
[110] *Ibid.*

another important reason to favour reorganization, in Edwards' view, was the public interest in the debtor company's survival. Where the debtor company supplied valuable goods or services, or employed many workers, courts had to consider the broader social and economic consequences of restructuring:[111]

> It thus becomes apparent that consumer, investor and labor groups as well as the public generally are interested in reorganizations, and accordingly their welfare should be kept in mind by those who are supervising that procedure.

Edwards also discussed the principles of "feasibility" and "fairness" that judges should take into account, in addition to the CCAA's purpose, when considering proposed arrangements under the Act. Importantly, Edwards concluded that Parliament had granted judges a fairly broad discretion in considering whether to approve a proposal under the Act by allowing them "to devise their own rules and criteria for the purpose."[112] In Edwards' view, although the CCAA had been modeled in part on section 153 of the English *Companies Act*,[113] there was no evidence that the Canadian Parliament had in mind any particular test – such as those established under English common law – that it intended for judges to apply in deciding CCAA cases. Thus, it was left to judges in CCAA proceedings to determine whether a plan was fair and equitable and should be approved in any given case.

Both Edwards and the Supreme Court, writing in *Re CCAA*, agreed on the basic purpose of the CCAA: to avoid a bankruptcy by allowing an insolvent company to reorganize. However, Edwards departed noticeably from the Supreme Court's interpretation by introducing the concept of the "public interest," a term that is never mentioned in the Supreme Court's decision. Significantly, the Supreme Court made no

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[111] *Ibid* at 593.
[112] *Ibid* at 614.
[113] *Companies Act 1929* (UK), 19 & 20 Geo V c 23. This is now the *Companies Act 2006* (UK), c. 46.

mention of the employees and communities that would suffer in the event of large business failures. Instead, the Supreme Court interpreted the CCAA narrowly, focusing on the legislative purpose of allowing courts to sanction compromises for the general benefit of creditors.[114] Nonetheless, the social and economic consequences of large corporate bankruptcies were key factors in Parliament's decision to enact the CCAA. Indeed, it was precisely because of the negative economic and social consequences arising from the wholesale liquidation of a large company – a common Depression-era bankruptcy scenario – that Parliament thought some legislation was required to allow insolvent companies to reorganize and survive.[115]

A final point is that that neither Parliament, the Supreme Court, nor Edwards foresaw the possibility that the CCAA would develop and evolve over time such that the statute might be used to effect the wholesale liquidation of a company's assets, since such a scenario at that time would only occur under bankruptcy, and not insolvency proceedings.

(iii) Modern Interpretations (1980s – Present) – The Courts of the Provinces

Canadian courts have generally adopted a broad, liberal interpretation of the CCAA's provisions. This is in keeping with the rule of statutory interpretation in section 12 of the *Interpretation Act*:[116]

> Enactments deemed remedial
>
> **12.** Every enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.

In *Re Chef Ready Foods Ltd.,*[117]the British Columbia Court of Appeal specifically

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[114] *Re Companies' Creditors Arrangement Act*, [1934] SCR 659 at para 7.
[115] *House of Commons Debates*, 17th Parl, 4th Sess, Vol 4 (1993) at 4090 (Hon CH Cahan).
[116] RSC 1985, c I-21.
[117] *Hongkong Bank of Canada v Chef Ready Foods Ltd* (1990), 4 CBR (3) 311 (BCCA).

acknowledged the judicial preference for a liberal approach and held that the CCAA's "broad scope" prevailed in any apparent conflict between the CCAA's provisions and those of the federal *Bank Act*.[118] The Court reaffirmed that this was the correct approach in *Quintette Coal Ltd v. Nippon Steel*,[119] citing *Chef Ready Foods* and upholding a lower court decision that the stay provisions in section 11 of the CCAA were to be read so as to give the court "broad powers...to assist reorganization."[120]

Similar statements about the need for a liberal interpretation of the CCAA and the court's powers under the Act are commonly found in Ontario court decisions. In *Elan Corp. v. Comiskey*,[121] Doherty J.A. of the Ontario Court of Appeal, citing *Chef Ready Foods* with approval, stated that "the Act must be given a wide and liberal construction" in fulfilling its purpose of facilitating a reorganization.[122] In *Re Lehndorff General Partner Ltd.*,[123]Farley J. of the Ontario Superior Court of Justice explained:[124]

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation.

Farley J. reiterated this explanation in the more recent *Re Air Canada*[125] case, and this decision continues to be cited commonly for its statement of the CCAA's purpose.

The above statements are consistent with the Alberta Court of Appeal's decision in *Re Smoky River Coal*.[126] In that decision, the Court of Appeal cited both *Re Lehndorff* and *QuintetteCoal* in holding that the CCAA required a broad and liberal

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[118] In the result, the court held that the CCAA's stay provisions applied equally to creditors holding section 178 securities under the *Bank Act*, SC 1991 c 46.
[119] (1990), 51 BCLR (2d) 105 (BCCA).
[120] Affirming *Quintette Coal Ltd v Nippon Steel* (1990), 47 BCLR (2d) 193 (BC Sup Ct).
[121] *Elan Corp v Comiskey* (1990), 1 CBR (3d) 101 (Ont CA), dissenting on other grounds.
[122] *Ibid* at para 61.
[123] 17 CBR (3d) 24 (Ont Sup Ct).
[124] *Ibid* at para 5.
[125] 2003 CarswellOnt 6102, (Ont Sup Ct).
[126] *Re Smoky River Coal Ltd* (1999), 175 DLR (4th) 703 (Alta CA).

interpretation.[127] Similarly, in *Oakwood Petroleums*, the Alberta Court of Queen's Bench stated that "a proper statutory construction of s. 11 of the C.C.A.A. is a wide one" and defended the constitutional validity of "a wide reading of the provisions of the C.C.A.A."[128]

The case law in Québec and the Atlantic provinces agrees with the above statements. In *ReNsC Diesel Power Inc*,[129] one of the few CCAA cases in Atlantic Canada, the Nova Scotia Supreme Court referred to the CCAA's Depression-era origins and its purpose of facilitating the reorganization of a debtor company so that it could continue as a going concern.[130]In a 2009 decision, the New Brunswick Court of Queen's Bench stated that restructuring was "the principle on which the *CCAA* is founded," going on to explain that restructuring could reorder the value of insolvent corporations "in a manner more coherent with public interest than that which might be available in bankruptcy."[131]

In *Steinberg Inc v Michaud*,[132] the Québec Court of Appeal stated that "today there is unanimous recognition of the statute's raison d'être", citing *Chef Ready Foods*:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business...

In the same judgment, the Québec court also relied on the Ontario Court of Appeal's statement on the purpose of the CCAA in *Elan Corp. v. Comiskey*[133] and the Alberta decision of *Oakwood Petroleums*. More recently, in the 2005 decision *Re MEI Computer*

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[127] *Ibid* at paras 31 and 51.
[128] *Norcen Energy Resources Ltd v Oakwood Petroleums Ltd* (1988), 72 CBR (NS) 1 (Alta QB). For a more recent statement, see *Re 843504 Alberta Ltd* (2003), 4 CBR (5th) 306 at para 13.
[129] (1990), 79 CBR (NS) 1 (NS Sup Ct).
[130] *Ibid* at para 9:
[131] *Re Long Potato Growers Ltd,* 2009 NBQB 349 at para 29.
[132] (1993), 55 QAC 298.
[133] *Elan Corp v Comiskey* (1990), 1 CBR (3d) 101 (Ont CA).

Technology Group Inc,[134] the Québec Superior Court stated that "Québec courts share the same vision as to the liberal interpretation of the *CCAA*" as courts in other provinces, agreeing that the CCAA should be given a "large and liberal interpretation."[135]

Taken together, these decisions demonstrate that there is strong agreement among the different courts of the provinces as to the general nature and purpose of the CCAA. There is also general agreement as to the wide scope of the court's discretion in CCAA proceedings, and the liberal interpretation that the court must apply to the Act's provisions. Broadly speaking, the CCAA is remedial legislation with the objective of facilitating the reorganization of insolvent companies so as to avoid the negative economic and social consequences of liquidation. However, while there is general agreement on this purpose, some recent decisions point to different judicial approaches to the Act. These divergences raise the question of whether it is appropriate to effect liquidations under the CCAA.

(iv) "Liquidating CCAAs"

(a) A Divergence in Judicial Interpretation

A great deal has been said in recent scholarship on the trend of "liquidating CCAAs" – the use of the CCAA regime to effect the eventual liquidation of the debtor company on a going concern basis, as opposed to a reorganization.[136] More will be said on this problem in Chapter V. However, this section will offer a brief outline of the problem as it relates to conflicting judicial interpretations of the CCAA.

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[134] [2005] RJQ 1558.
[135] *Ibid.*
[136] For critiques of this trend, see Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" [2008] Annual Rev Insol L 42; Bill Kaplan, "Liquidating CCAAs: Discretion Gone Awry?" [2008] Ann Rev Insol L 79.

As discussed above, courts have traditionally understood the CCAA as a mechanism for ensuring the survival of an insolvent company as a going concern, where the needs of the company's creditors and the public interest would be better served than in a liquidation. Furthermore, it is implicit in this interpretation that liquidation typically has negative social and economic consequences. As was discussed in Chapter I of this thesis, the CCAA was enacted precisely to allow insolvent companies to survive and avoid liquidation. The Act was designed to complement the established bankruptcy regime in which liquidation was the only option. It may seem strange, then, that recent decisions in Ontario have approved liquidations under the CCAA, termed "liquidating CCAAs." This trend is *prima facie* in conflict with the more traditional judicial approaches of courts in Alberta and British Columbia.

(b) Ontario Decisions

In *Canadian Red Cross Society*,[137] Blair J., as he then was, approved a CCAA sale of all of the blood supply assets and operations of the Red Cross in the face of roughly $8 billion of tort claims. Notably, this was done before a restructuring plan had been put to the creditors for a vote. Likewise, in *Re Consumers Packaging Inc*,[138] the Ontario Court of Appeal affirmed the lower court's approval of a CCAA sale of substantially all of the debtor company's assets before a creditor vote. Along the same lines, in *Re 1078385 Ontario Ltd* (*Bob-Lo Island*),[139] the Ontario Superior Court approved a plan of arrangement in which all of the debtor company's assets would be sold to the secured

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[137] *Re Canadian Red Cross Society*, [1998] OJ No 3306 (QL) (Ont Gen Div), leave to appeal refused.
[138] (2001), 27 CBR (4th) 197 (Ont CA).
[139] *Re 1078385 Ontario Ltd* (2004) 16 CBR (4th) 144 (Ont Sup Ct); leave to appeal refused, [2004] OJ No 6050 (QL) (Ont CA).

creditors who had proposed the plan, with no proceeds remaining for the unsecured creditors. In his decision, Quinn J. noted that plan was:[140]

> …a shortcut in the realization of the assets without satisfactory evidence of value and safeguards with regard to proof of the debt. To a certain extent, that is true, but I think that is the nature of the CCAA. We have to balance moving this procedure forward in a much quicker fashion than if we proceeded under a bankruptcy.

In allowing the secured creditors to use the CCAA as a collection tool, *Bob-LoIsland* effectively rejected the traditional approach to the CCAA as a statute designed to facilitate the survival of the debtor company as a going concern.[141]

(c) Québec Decisions

The Ontario approach has not been adopted wholeheartedly in other provinces. In a recent decision, the Québec Superior Court approved a plan to sell substantially all of the debtor company's assets where the plan was found to meet the CCAA's broad remedial purpose and allowed the company to carry out its business with the least harm to its stakeholders.[142] However, in *Re Mecachrome International Inc*,[143] the Québec Superior Court refused to approve a plan in which the DIP lenders were to acquire all of the debtor company's shares. The court stated that the aim of the CCAA was to enable the debtor company to continue as a going concern for the benefit of its creditors and the public interest. In the case, these aims had been frustrated by a lack of transparency and the debtor company's failure to canvass the market for other offers. As such, courts in Québec historically have applied greater scrutiny to liquidating CCAAs.

(d) British Columbia and Alberta Decisions

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[140] *Ibid* at para 125.

[141] For example, see Ground J.'s reasoning in *obiter* in *Enterprise Capital Management Inc v Semi-Tech Corp* (1999), 10 CBR (4th) 133 (Ont Sup Ct) at 142-143, stating that it would be inappropriate to approve a plan under the CCAA where the secured creditors were simply seeking to enforce their rights and liquidate the company by means other than the trust indentures.

[142] *Re Railpower Technologies Corp*, 2009 QCCS 2885 (Que Sup Ct).

[143] [2009] RJQ 1302 (Que Sup Ct).

Western courts generally have been skeptical of liquidating CCAAs, and some have expressed concern with the Ontario approach. In *Re Fracmaster*,[144] the Alberta Court of Queen's Bench refused to approve a sale plan in which the debtor company would have sold substantially all of its assets. The court stated:[145]

> It is generally accepted that the *CCAA* is not to be used to wind-up or liquidate a company, although there are some circumstances in which the *CCAA* can be used in such a way.

The court accepted that the CCAA could be used in a liquidation scenario in theory. However, a liquidation plan had to be "workable or practical" in the sense that it was in the creditors' interests and that it attended to "economic reality."[146] Where there is no added value to be gained for both the company and its stakeholders in a CCAA plan, then the usual liquidation mechanisms in the bankruptcy regime should be used to wind-up the insolvent company.

In *Cliffs Over Maple Bay*,[147] the British Columbia Court of Appeal overturned a lower court decision granting a section 11 stay of proceedings in favour of the debtor company and authorizing DIP financing under the CCAA. The debtor company was a single purpose developer of a golf course and residential development that had filed for CCAA protection only after its secured creditors had appointed a receiver according to the terms of their credit agreements. The Court of Appeal rejected the stay and DIP financing requests on the grounds that there was no business to rescue, and went on to register its skepticism of the Ontario approach:[148]

> I need not decide the point on this appeal, but I query whether the court should grant a stay under the *CCAA* to permit a sale, winding up or liquidation without requiring the

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[144] (1999), 11 CBR (4th) 204 (Alta QB); aff'd (1999), 11 CBR (4th) 230 (Alta CA).
[145] *Ibid* at para 20.
[146] *Ibid* at paras 24-25, 28 and 39.
[147] *Cliffs Over Maple Bay Investments Ltd v Fisgard Capital Corp*, 2008 BCCA 327.
[148] *Ibid.* at para 32.

> matter to be voted upon by the creditors if the plan of arrangement intended to be made by the debtor company will simply propose that the net proceeds from the sale, winding up or liquidation be distributed to its creditors.

While this statement was *obiter*, it nonetheless questions the rule laid down in the Ontario decisions of *Re Consumers Packaging Inc.*[149]and *Canadian Red Cross Society*,[150] discussed above.

(v) The Supreme Court of Canada

In the recent *Century Services v. Canada (Attorney General)*[151]case,the Supreme Court of Canada interpreted the CCAA for the first time in over 75 years. In an 8-1 decision, the Court restored the order of a CCAA chambers judge denying the Crown's motion for payment of unremitted taxes by a company under CCAA protection. The Supreme Court stated that Parliament had intended a "broad reading of *CCAA* authority" and held that the lower court had "failed to…give the statute an appropriately purposive and liberal interpretation."[152] This interpretation is consistent with the broad and liberal approach to the CCAA endorsed by courts across the provinces.

Writing for the majority,[153] Deschamps J. stated that a proper interpretation of the CCAA's provisions required an examination of "the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence."[154] Discussing the CCAA's history, Deschamps J. referred to the "battering visited upon Canadian businesses by the Great Depression" that necessitated insolvency legislation allowing companies to avoid

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[149] (2001), 27 CBR (4th) 197 (Ont CA).
[150] [1998] OJ 3306 (Ont Gen Div), leave to appeal refused.
[151] 2010 SCC 60.
[152] *Century Services v Canada (Attorney General)*, 2010 SCC 60 at paras 68 and 73.
[153] In separate but concurring reasons, Fish J. agreed with Deschamps J.'s analysis and the "important historical and policy reasons" that she developed in support of the decision. *Ibid* at para 94.
[154] *Ibid* at para 11.

liquidation by reorganizing.[155] Deschamps J. went on to emphasize the remedial purpose of the statute:[156]

> Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected — notably creditors and employees — and that a workout which allowed the company to survive was optimal.

The Supreme Court also emphasized the public interest purpose of the CCAA. Citing Stanley Edwards' article, Deschamps J. acknowledged that insolvency might affect stakeholders beyond creditors and employees. In such cases, reorganization can serve the public interest by facilitating the survival of insolvent companies, thus saving jobs, goodwill, and allowing companies to continue supplying goods or services that are crucial to the economy.[157] Therefore, reorganization may be "justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid negative consequences of liquidation."[158]

Deschamps J. distinguished the CCAA from other Canadian insolvency legislation for the "broad and flexible authority" that it granted to the supervising court in making the "orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA's* objectives."[159] At the same time, Deschamps J. noted that since the CCAA contains no provisions for failed reorganizations, the liquidation regime in the BIA "necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful."[160] This is a crucial difference between the BIA and CCAA, and it bears directly on the question of whether wholesale liquidations should be permitted under the CCAA as opposed to reorganizations. Although Deschamps J. did not consider

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[155] *Ibid* at para 16.
[156] *Ibid* at para 17.
[157] *Ibid* at para 18.
[158] *Ibid* (emphasis added).
[159] *Ibid* at para 19.
[160] *Ibid* at para 23.

this question, her later discussion of the scope and limits of the supervising judge's authority under the CCAA provides useful guidance:[161]

> The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company.

While this statement leaves open the possibility of liquidations under the CCAA, it implies that these should be rare for several reasons. Firstly, the optimal outcome of CCAA proceedings is the survival of the insolvent company.[162] Liquidation necessarily precludes this optimal outcome. Secondly, the liquidation of an insolvent company is often harmful to its stakeholders.[163] For this reason, liquidation often runs counter to the CCAA's remedial purpose of avoiding social and economic losses. At a minimum, a court that is asked to sanction a CCAA liquidation must determine whether the liquidation will avoid the "social and economic losses resulting from liquidation" of the insolvent company. Furthermore, the court should consider the practical effects of such an order on all the stakeholders, since "the chances for successful reorganizations are enhanced where participants achieve common ground and <u>all stakeholders are treated as advantageously and fairly as the circumstances permit</u>."[164] Finally, liquidation typically will occur after reorganization has failed, and it should follow the BIA regime.[165] If a proceeding is aimed only at liquidation, and the liquidation regime should be the same under both statutes, then it would make more sense to begin that proceeding under the BIA rather than the CCAA. These reasons will be discussed in greater detail in Chapter V.

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[161] *Ibid* at para 70.
[162] *Ibid* at para 17.
[163] *Ibid.*
[164] *Ibid* (emphasis added).
[165] *Ibid* at 23.

The *Century Services* decision is an important milestone in the evolution of the CCAA for two reasons. Firstly, *Century Services* reiterates the basic legislative objective of the CCAA as stated in *Re CCAA*, namely, to allow an insolvent company to reorganize and thus avoid bankruptcy and the liquidation of its assets.[166] Secondly, *Century Services* represents a departure from *Re CCAA* by emphasizing the importance of the "public interest" in reorganization. This is significant. Like Edwards, the Supreme Court in *Century Services* recognized that the CCAA is more than a legislative mechanism for facilitating compromises between debtors and creditors. This difference in interpretations may be explained by the fact that *Re CCAA* was a constitutional reference. The Supreme Court limited its analysis in the decision to the question of whether the CCAA was within Parliament's authority to enact. It did not interpret the provisions of the statute directly. At the same time, the emphasis on the public interest in *Century Services*, a concept that is never referenced in *Re CCAA*, is an acknowledgment that the CCAA has evolved since it was enacted in 1933.[167] This evolution is consistent with Parliament's original objective of avoiding the negative social and economic consequences of liquidation.

(vi) Conclusion

This chapter has examined some of the key decisions in the history of the CCAA. It has sought to provide a comprehensive account of the CCAA's purposes by examining the early cases and commentaries, recent decisions of the courts of the provinces, and the Supreme Court of Canada's decision in *Century Services*. This examination of the

[166] *Reference re Companies' Creditors Arrangement Act*, [1934] SCR 659 at para 17.

[167] This evolution has been acknowledged in various commentaries on the CCAA. For example, Janis Sarra notes that the CCAA's provisions aim to facilitate arrangements between debtors and creditors, but recent case law has emphasized the importance of the public interest. Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations*, (Toronto: University of Toronto Press, 2003) at 4. See also Roderick J Wood, *Bankruptcy and Insolvency Law*, (Toronto: Irwin Law, 2009) at 314.

CCAA's history and purpose provides the background for the chapters that follow. These chapters discuss the CCAA's place in Canada's bankruptcy and insolvency regime, the rules on asset sales under section 36, and the problem of liquidations under the statute.

A few points arise from the analysis in this chapter. Firstly, despite general agreement as to the purposes and application of the CCAA, there is a divergence in judicial interpretation on the issue of liquidating CCAAs. This divergence is particularly evident in the Ontario and Western decisions discussed here. The *Century Services* decision has not resolved this problem because the decision does not specifically discuss liquidating CCAAs. While *Century Services* implies that liquidating CCAAs should be rare, the Supreme Court of Canada has left the question open for future argument. For the same reason, section 36 of the CCAA, a new section on the court approval of asset sales that was added in 2009, does not resolve the problem of liquidations. While section 36 grants courts the authority to sanction asset sales, it does not say exactly how courts should exercise this authority. For example, section 36 does not say whether it is appropriate to sanction a proposed liquidation before a plan of arrangement is filed and the creditors have voted in favour of the liquidation.[168] This will be discussed further in Chapter IV.

Secondly, the public interest is an important consideration in CCAA proceedings. The recent *Century Services* case emphasizes the public interest aim of the CCAA and represents a departure from the Supreme Court's earlier, narrower reading in *Re CCAA* that focused only on the debtor-creditor relationship. The role and meaning of the public interest in the restructuring context will be discussed further in Chapter III.

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[168] Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" (2008) *Annual Review of Insolvency Law* 33 at 44-45.

III. A THEORY OF RESTRUCTURING

(i) Introduction

The first two chapters of this thesis examined the history and purpose of the CCAA. This chapter examines competing theories of restructuring in order to understand the CCAA's role in the broader context of Canada's bankruptcy and insolvency system.

Many of the sources discussed in this chapter are American. Although the U.S. literature does not address the CCAA or the Canadian bankruptcy system specifically, the articles are still instructive because of their critique of the purposes and limits of restructuring. Also, various researchers have demonstrated the usefulness of comparative analyses of U.S. and Canadian reorganization law.[169] Furthermore, U.S. bankruptcy theory is now more relevant to Canadian law with the growing prevalence of Canada-U.S. cross-border insolvency proceedings.[170] These proceedings have imported aspects of U.S. restructuring law into Canadian law, such as stalking horse auctions and DIP financing, while the recent adoption of the UNCITRAL Model Law[171] has led to greater harmonization of bankruptcy and insolvency law in both countries. In particular, DIP financing procedures have been codified in the new section 11.2 of the CCAA[172] as well as section 50.6 of the BIA.[173]

This chapter begins by examining modern critiques of restructuring and its place in a bankruptcy system. It proceeds with a consideration of the CCAA in light of these

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[169] For example, see Lynn M Lopucki and George G Triantis, "A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies" (1994) 35 Har Int'l LJ 267; Yaad Rotem, "Contemplating a Corporate Governance Model for Bankruptcy Reorganizations: Lessons from Canada" (2008) 3 Va L & Bus Rev 125.

[170] For example, see *Re AbitibiBowater Inc*, 2010 QCCS 1742 (Que SC); *Re Nortel Networks Corp* (2009), 55 CBR (5th) 229 (Ont Sup Ct).

[171] United Nations Commission on International Trade Law, *Model Law on Cross-Border Insolvency*, GA Res 52/158, arts 25-27, UN Doc A/Res/52/158 (Jan 30, 1998).

[172] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 s 11.2.

[173] *Bankruptcy and Insolvency Act*RSÇ1985cB3s 50.6.

critiques and suggests that serving the "public interest" – a broader constituency of stakeholders than traditional creditors such as lending institutions – is an important objective of restructuring law.

(ii) Why Restructure? Competing Theories of Restructuring and Its Usefulness

(a) The "Going Concern Value" Premise

A common justification for restructuring is that it maximizes value for creditors. The premise is that a debtor company is worth much more as a going concern than what would be obtained through a piecemeal liquidation of the debtor's assets in bankruptcy.[174] By preserving the status quo and allowing the debtor time to reorganize its business and negotiate new financing arrangements, restructuring avoids "fire sale" scenarios and maximizes value for the company's creditors.[175] However, some commentators have suggested that a bankruptcy or receivership liquidation may be preferable to restructuring, since it is still possible in these cases to liquidate a debtor's assets on a going concern basis without the additional costs of a restructuring.[176] Many reasons are given why restructuring might be preferable to the bankruptcy or receivership options: for instance, there may be few potential buyers for the debtor's business, requiring a more flexible sale process that is only possible in restructuring; it may be impossible to sell the business as a going concern where some creditors have security interests on key assets; and bankruptcy may not stay some creditors from enforcing their security interests. Additionally, some argue that restructuring generally affords more time for the debtor to prepare a reorganization or sale plan, and takes advantage of the

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[174] Roderick J Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2009) at 313.
[175] For example, see Stanley E Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) 25 Can Bar Rev 587, in which the author argues that the CCAA is intended, among other things, to avoid "improvident sales" of a debtor company's assets.
[176] Roderick J Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2009) at 313. These additional costs would include, for example, negotiations between creditors and the debtor company.

specific experience and knowledge of the debtor company's management.[177] The debtor company's management would not remain in place in a bankruptcy or receivership.[178]

According to the "going concern value" account, restructuring is important because it prevents creditors from seizing a debtor company's assets whenever the company encounters financial difficulty, potentially destroying value. Calling this account the "Debtor in Control narrative", David Skeel explains:[179]

> According to this narrative, bankruptcy is designed to preserve "going concern value" when a large company stumbles. To achieve this objective, bankruptcy prevents creditors from making grabs for the company's assets, and it gives the debtor's management an opportunity to negotiate with its creditors over the terms of a reorganization plan.
>
> [. . .]
>
> The Debtor in Control narrative suggested that the company and its team of professionals should be given plenty of time to determine what went wrong and work with its creditors to develop a plan for a healthier future. The narrative included an appeal to patience and for sympathy for the distressed company.

Skeel suggests that the Debtor in Control paradigm has since been supplanted by a new opposing narrative, which he calls "No Time to Spare", which emphasizes immediate court approval of a new financing arrangement and the sale of the distressed company's assets "because the company's assets are a melting ice cube and will. . . evaporate unless the court springs immediately into action."[180]

Both the Debtor in Control and No Time to Spare paradigms assume that restructuring is preferable to bankruptcy because it preserves the going concern value of the debtor's assets. This is not a new idea. While Skeel suggests that the Debtor in

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[177] *Ibid.* This may be a double-edge sword: as skilled as incumbent management may otherwise be, they may still be implicit in the company's insolvency. It is therefore reasonable to ask whether incumbent management is in the best position to steer the company back to profitability.

[178] Although historically a receiver did not necessarily have power of management, most court-appointed receivers now are receiver-managers. See Roderick J Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law, 2009) at 458.

[179] David A Skeel, Jr, "Competing Narratives In Corporate Bankruptcy: Debtor In Control vs. No Time To Spare" (2009) Mich St L Rev 1187 at 1198.

[180] *Ibid* at 1199.

Control and No Time to Spare paradigms emerged in the 1980s and 1990s, respectively,[181] Stanley Edwards argued as early as 1947 in the Canadian context that restructuring is preferable to bankruptcy because it preserves going concern value.[182] In other words, the idea – central to both of the narratives that Skeel discusses – that restructuring preserves going concern value and is therefore preferable to a liquidation in bankruptcy, has been prominent in restructuring theory since restructuring laws were first enacted. More recently, this premise has come under attack from a variety of theorists with differing views of restructuring. These criticisms, in turn, have led to responses from proponents of restructuring who have argued that restructuring is worthwhile even when it does not maximize value for creditors, narrowly defined. Rather, these proponents argue that the legitimate goals of restructuring include the rehabilitation of the debtor company for the benefit of a broader constituency of stakeholders. These stakeholders may include employees, suppliers, and communities that are dependant, to varying degrees, on the debtor company. These opposing views are discussed below.

(b) Debt Collection Theory and Restructuring's Skeptics

Debt collection theory holds that the bankruptcy process should aim primarily to resolve creditors' collection problems in order to maximize returns. This view emphasizes the historical aim of bankruptcy law of providing creditors with a compulsory and collective forum to sort out their claims.[183] In other words, bankruptcy law resolves the collective action problem that arises when a debtor defaults on debts to multiple

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[181] *Ibid.*

[182] Stanley E Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) Can Bar Rev 587.

[183] Thomas H Jackson, *The Logic and Limits of Bankruptcy Law* (Cambridge, Massachusetts: Harvard University Press, 1986) at 2. Jackson notes that bankruptcy law also has as its goal the rehabilitation of the bankrupt – giving the bankrupt a "fresh start" – though this was not historically regarded as a legitimate aim alongside debt collection. See below.

creditors. In the absence of the bankruptcy process, the creditors would scramble to seize the debtor's assets, leading to the collapse of the debtor's business as a going concern, and leaving most creditors and the shareholders worse off.[184] Bankruptcy law forces the creditors to work collectively on the assumption that they are better off acting as a group. By facilitating this "creditors' bargain", the bankruptcy system does its best to enforce entitlements that existed prior to bankruptcy.[185]

Notably, while some debt collection theorists have acknowledged that the rehabilitation of the debtor is also a legitimate aim of bankruptcy law,[186] it is a mistake to assume that rehabilitation in itself was an objective of bankruptcy law before the modern era. As Emily Kadens' research shows, a bankrupt's refusal to cooperate in repaying creditors was a capital offence in 18th century England, and the possibility of a discharge was introduced only to incentivize the bankrupt's cooperation – not because rehabilitation and a "fresh start" for the debtor were thought to be worthy goals in themselves.[187] Moreover, this historical concept of rehabilitation was connected to the individual debtor, not the corporation. This fact may be a problem for debt collection theorists who wish to acknowledge the legitimacy of the rehabilitative goal of modern bankruptcy law, particularly with respect to corporations. Rehabilitation as a goal in itself, and the notion of sympathy for the debtor, are relatively new concepts that are not always consistent with the goal of maximizing returns for creditors. Also, the concept of rehabilitation and sympathy for the individual is quite different from the concept of

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[184] *Ibid* at 10-19.

[185] See Thomas H Jackson, "Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain" (1982) 91 Yale L J 857 at 871: "[B]ankruptcy law should make a fundamental decision to honor negotiated non-bankruptcy entitlements."

[186] *Ibid* at 2.

[187] Emily Kadens, "The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law" (2009-2010) 59 Duke LJ 1229.

rehabilitation of the corporation. The latter is an even newer idea in the history of bankruptcy law.

Debt collection theory does not necessarily preclude restructuring. Where a business is worth more as a going concern than what would be achieved in a piecemeal liquidation, it follows that the creditors stand more to gain from its survival. However, some debt collection theorists have argued that liquidation in bankruptcy is often preferable to restructuring. For example, Baird and Rasmussen have argued that the assets of an insolvent company will not always hold greater going concern value than what would be realized through a piecemeal liquidation:[188]

> In short, many assets work equally as well in one firm as another. Other assets that are tailored to a specific firm may not represent a source of value but the source of failure. Our point here is a cautionary one. One can point to neither the size of a firm alone nor the existence of firm-specific assets to conclude that corporation reorganization law has an important role to play in our modern economy.

This argument directly challenges the account that restructuring is preferable to piecemeal liquidation because it preserves going concern value. For example, in a traditional account of the purposes of restructuring, Stanley Edwards explained:[189]

> It may be that the main value of the assets of a company is derived from their being fitted together into one system and that individually they are worth little. The trade connections associated with the system and held by the management may also be valuable. In the case of a large company it is probable that no buyer can be found who would be willing to buy the enterprise as a whole and pay its going concern value. The alternative to reorganization then is often a sale of the property piecemeal for an amount which would yield little satisfaction to the creditors and none at all to the shareholders.

On Edwards' account, the function of the CCAA – Canada's restructuring statute – was to "keep a company going despite insolvency", that is, to protect the debtor company

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[188] Douglas G Baird and Robert K Rasmussen, "The End of Bankruptcy" (2002-2003) 55 Stan L Rev at 768.

[189] Stanley E Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) Can Bar Rev 587 at 592.

from bankruptcy so that it could reorganize its business to the advantage of its stakeholders.[190]

Douglas Baird and Robert Rasmussen have suggested that financial innovations and the changing nature of firms have led to a "new world of corporate reorganizations" in which restructuring often results in less optimal outcomes than bankruptcy.[191] For example, they argue that because some modern firms have "hundreds or thousands of subsidiaries, there is no easy way to sort out the rights of creditors, even though they are all nominally general creditors."[192] The result is that restructuring law can no longer resolve the collective action problems that arise among creditors with many similar claims. Instead, these creditors' interests are so fragmented that it is difficult or impossible for them to agree on a restructuring plan in such cases.[193]

New types of financial instruments such as credit default swaps compound the problem of fragmented creditor interests. The holders of these and other derivatives, while nominally creditors, will rarely have interests similar to those of other general creditors of a company because they are only concerned with their returns with respect to a "credit event" – i.e. an event that triggers bankruptcy – without regard to any other aspect of the debtor company's situation.[194] Moreover, new entities like hedge funds have now become important lenders, but hedge funds operate much differently than traditional lenders like banks because they often have a short life, do not provide the

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[190] *Ibid.*
[191] Douglas G Baird and Robert K Rasmussen, "Antibankruptcy" (2010) 119 Yale LJ 648 at 652.
[192] *Ibid* at 658.
[193] *Ibid* at 657.
[194] *Ibid* at 680.

services of banks, and are not subject to the same reputational constraints. As Baird and Rasmussen explain:[195]

> Banks make their profit by lending and having it paid back. They do not seek to own and operate the business. Not so with hedge funds. A hedge fund may buy the loan with the view that in the event of default it would be left with the business, and given the amount at which it purchased the notes, it would not be a bad price at which to acquire it even if it were in financial distress. Banks want their money back; hedge funds loan to own. The same dynamic that plays out with respect to publicly traded unsecured debt now plays out with respect to traditional bank debt as well.

According to this argument, the result of new instruments like credit swaps and new players like hedge funds is that creditor interests are highly fragmented, such that restructuring will be inefficient or even impossible because a debtor company's creditors will not fall into a few diverse but similarly situated groups.

Following Baird and Rasmussen, Jassmine Girgis has suggested that the nature of the modern firm has changed such that corporate reorganizations may no longer be value-enhancing. This argument emphasizes the new value that firms hold beyond fixed, firm-specific assets:[196]

> When the process of corporate reorganization arose, it did so because the firm elements were firm-specific – they would retain the most value by remaining in the particular firm. There was therefore incentive to keep the firm operating as a going concern. But over the last century, the elements of a firm have been changing. The physical elements have become less firm-specific. Firms have moved away from large manufacturing entities and are now more oriented toward providing service and data. This means that the value of networks, the knowledge, the relationships may have surpassed the value of the physical assets.

On this account, in the past, it made sense to preserve firms whose assets were primarily fixed and firm-specific because these assets could not be liquidated easily at full value. However, since many modern firms are no longer large manufacturers that rely on fixed, firm-specific assets, restructuring may not serve any purpose because these assets are easily liquidated at full value, and therefore the need to preserve the firm has been lost.

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[195] *Ibid* at 670.

[196] Jassmine Girgis, "Corporate Reorganization and the Economic Theory of the Firm" [2011] Ann Rev of Insol L 467 at 491.

Notably, even if we grant that restructuring may no longer enhance value for many firms because they are service providers rather than manufacturers, restructuring remains important and potentially value enhancing for at least two reasons. Firstly, manufacturers still comprise a major sector of the Canadian economy. It is helpful to compare manufacturers with professional services firms. Professional services firms seem to exemplify the new types of firms that Girgis discusses: they rely mainly on human capital and they possess far greater value in their networks, knowledge and relationships than their fixed assets. Manufacturers continue to represent a significantly larger portion of Canadian GDP than professional services firms.[197] This suggests that restructuring remains potentially quite important for a large sector of the Canadian economy even if the changing nature of firms has rendered restructuring irrelevant for some. Secondly, as Girgis suggests, restructuring could remain relevant even for firms whose assets are mainly expertise and relationships because these assets might be firm-specific. For example, some aspects of human capital may be lost when transferring from one firm to another because "there is general know-how, not necessarily attached to particular individuals, locked up in the firm itself."[198] Such know-how might include the knowledge of firm contacts or the strengths and weaknesses of colleagues. This "organizational capital" resides in the firm, making it difficult to transfer "unless the entire network can be transferred to another firm."[199]

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[197] Despite a decrease for the sector since 2001, manufacturing was $151 billion of Canadian GDP in 2009, compared to $60.6 billion for professional services. Also, manufacturing represented $362.5 billion in accumulated capital investments in 2009, compared to $26 billion for professional services. See Canadian Industry Statistics (CIS), Industry Canada, online: <http://www.ic.gc.ca/eic/site/cis-sic.nsf/eng/Home>.
[198] Jassmine Girgis, "Corporate Reorganization and the Economic Theory of the Firm" [2011] Ann Rev of Insol L 467 at 481.
[199] *Ibid.*

In evaluating the argument that corporate restructuring has become inefficient or ineffective due to the modern nature of firms and financial innovation, it is useful to consider the history of restructuring. David Skeel points out that early restructuring was not always a clean and organized process in which a diverse group of creditors found common ground through negotiation:[200]

> This overview is quite sanitized, of course. Sometimes the railroad and its banks were at loggerheads, or the court would refuse to appoint an interim receiver. Sometimes, an outsider would set up its own committee and try to wrest control of the process away from the debtor's principal investment banks. There were corporate raiders in the early twentieth century, just as there are now.

In other words, corporate restructuring historically involved complex arrangements between firms and their creditors, as well as creditors possessing what Baird and Rasmussen would call fragmented interests. Significantly, this fragmentation did not hinder many past restructurings or precipitate the demise of restructuring law. Therefore, the mere fact of further complexity and fragmentation in modern cases does not necessarily spell the demise of corporate restructuring as an effective tool for preserving value. Restructuring has never been simple and straightforward. As Baird and Rasmussen themselves conclude, the problem of the "empty core" – that is, the absence of a stable equilibrium of interests that allows creditors to reach consensus – might well be resolved by the supervising judge in the restructuring process, who can interpret the law so as to promote consensus.[201]

At the same time, while many firms now focus on services and data and hold considerable intangible assets, many other firms still hold fixed assets as well. Presumably, on Girgis's account, corporations holding fixed assets would still benefit

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[200] David A Skeel, Jr, "Competing Narratives In Corporate Bankruptcy: Debtor In Control vs. No Time To Spare" (2009) Mich St L Rev 1187 at 1191.
[201] Douglas G Baird and Robert K Rasmussen, "Antibankruptcy" (2010) 119 Yale LJ 648 at 699.

from restructuring. Examples of large firms that have undergone restructuring recently include GM, Chrysler, and AbitibiBowater – manufacturers with mostly fixed assets in the form of property and equipment. Moreover, the emergence of firms focused on data or services is not entirely new. Large professional services firms have existed for some time, but the number of filings in recent years shows that there remains strong demand for restructuring law as a mechanism for redeploying the assets of many different sorts of firms, at least so long as those firms have considerable fixed assets.[202]

(c) Market Theory

Market theorists hold that restructuring's main purpose should be the efficient operation of the markets. In practical terms, this means that market forces, not the government, should decide whether a company ought to be liquidated or restructured, and how to maximize returns for creditors. Proponents of this account argue that restructuring is unnecessary to preserve an insolvent firm's value since creditors could make private agreements before insolvency that would preserve such value through collective remedies. In such cases, restructuring would only be justified where it is more efficient than the alternatives available in private law, namely new types of contracts amongst creditors and debtors.[203]

Pure market theory has been criticized for failing to recognize that the state has already intervened in many ways to regulate the economy, whether through securities

[202] Again, recent examples such as GM, Chrysler, and Abitibi are pertinent. Nortel also had considerable fixed assets in the form of equipment that were sold through the restructuring process. Many more examples could be added, such as: Calpine, a major energy company whose restructuring was one of the largest in Canadian history; Stelco, now part of U.S. Steel; and Cadillac Fairview, which owns extensive commercial real estate developments across Canada.

[203] Barry Adler, "Financial and Political Theories of American Corporate Bankruptcy" (1992-1993) 45 Stan L Rev 311. Adler proposes a new form of arrangement known as "chameleon equity", in which a firm could issue a set of fixed obligations whose holders would be entitled to interest payments but not to collect individually on an obligation in default. This would avoid inefficiencies such as individual creditors forcing the premature liquidation of the debtor. *Ibid.* at 323-324.

regulators or corporate legislation. Moreover, the outcomes of restructuring are often influenced not only by the market, but by legal and political factors as well.[204] Consequently, it is a mistake to assume that market forces will operate freely in the absence of restructuring legislation. Rather, other factors such as government and regulators' decisions will continue to affect market forces, with perhaps less than ideal results from the perspective of pure market theory. As such, for their basic argument to succeed, market theorists must prove that restructuring renders the current imperfect system less efficient than it otherwise would be. This is an additional burden to proving the basic point that restructuring is less efficient from the point of view of an ideal free market.

(d) Loss Distribution and Rehabilitation Theory

According to the "loss distribution theory", bankruptcy law is more than a system for resolving the debt collection problems of traditional creditors.[205] Rather, the bankruptcy process should also consider the many different interests affected by corporate failure – including those of customers, employees, and communities – often collectively termed the "public interest" and recognized by Canadian courts in CCAA proceedings.[206] On this account, the bankruptcy process should sort out the entitlements of this broader group of creditors as well. In varying degrees, this account has informed the historically dominant approaches to restructuring in many modern countries, including Canada and the United States. However, the precise meaning of the term

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[204] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003) at 36.

[205] For example, see Elizabeth Warren, "Bankruptcy Policy" (1987) U Chi L Rev 775; "Bankruptcy Policy Making in an Imperfect World" (1993) 92 Mich Law Rev 336.

[206] Stanley E Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act", (1947) 25 Can Bar Rev 587 at 593. For judicial recognition of the public interest aim of the CCAA, see: *Re Metcalfe & Mansfield Alternative Investments II Corp*, 2008 ONCA 587 at paras 51-52, 61; *Century Services v Canada (Attorney General)*, 2010 SCC 60 at paras 16-18, 60.

"public interest", and the extent to which it should be given priority over the interests of traditional creditors in a restructuring, remains unclear.

Janis Sarra has argued that maximizing value for a narrowly defined group of creditors – in practical terms, senior secured lenders are often the only creditors to realize returns in a liquidation in bankruptcy – is just one of the many goals of corporate reorganization:[207]

> Market and debt collection theories are limited in their analysis because their definition of interest recognizes only equity and debt capital investment in the firm. They ignore the other investments that contribute value and which may be vitally important to decision making in terms of wealth maximization.

Similarly, Donald Korobkin argues that reorganization law reflects the fact that a corporation engages much broader interests than those of lenders. In his view, a corporation is not merely "a lifeless pool of assets," but has the potential to be a moral, political and social actor:[208]

> The law of corporate reorganization developed as a corrective to a bankruptcy jurisprudence that would have ignored a financially distressed corporation's dynamic potential. It reflected a means of bringing the corporation's dynamic personality into public view and regulating not merely its economic divisions, but the playing out of its moral, political and social views.

Like other rehabilitation theories, this view holds that courts should be given broad discretion in recognizing the broader interests at play in bankruptcy.[209] However, Korobkin departs from traditional rehabilitation theory in emphasizing a "value-based" account of bankruptcy law that directly challenges the economic account espoused by Jackson, Baird and others:[210]

> The economic account has misidentified the distinct function of bankruptcy law because, fundamentally, it has tracked the wrong problem from the start. The economic account

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[207] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003) at 41.
[208] Donald R Korobkin, "Rehabilitating Values: A Jurisprudence of Bankruptcy" (1991) 91 Colum L Rev 717 at 745.
[209] *Ibid* at 774-775.
[210] *Ibid* at 762.

> views bankruptcy law as a response to the economic problem of collecting debt. In contrast, the value-based account is founded on a deeper understanding of the concern to which bankruptcy law is addressed. Bankruptcy law is a response to the problem of financial distress-not only as an economic, but as a moral, political, personal, and social problem that affects its participants.

In Korobkin's view, a corporation develops a moral and political character through "the choices of the parties who participate in its decisions."[211] Over time, these participants define and redefine not only the economic aims of the corporation, but also its social, political and moral aims. As such, the fundamental question in bankruptcy is not what to do with the assets of the corporation, but what the corporation should exist to do. Bankruptcy law is distinct because no other system responds to the problem of financial distress in this way.[212] Thus, as a normative account, the value-based approach answers the challenge of economic-based theorists to explain why some entitlements ought to change in bankruptcy. Another significant departure of the value-based account from other rehabilitation theories is that it does not focus on the survival of the distressed corporation itself. Instead, the value-based account favors any process – reorganization or liquidation – that results in the "rehabilitation of the values of its participants."[213] That is, rehabilitation is deemed successful when it corrects the problems of those affected by the financial distress of the corporation.

James Bowers has criticized the value-based account on the grounds that bankruptcy law is primarily concerned with economic phenomena such as "lending, borrowing, financial losses, stocks, bonds, contracts, payments, and security interests."[214] Moreover, the fact that bankruptcy legislation contains redistributive provisions does not,

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[211] Ibid at 770.
[212] *Ibid* at 766.
[213] *Ibid* at 774.
[214] James W Bowers, "Whither What Hits the Fan? Murphy's Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution" (1991-1992) 26 Ga L Rev 27 at 69.

in itself, mean that economic theory cannot contribute meaningfully to a dialogue about those provisions by raising important normative questions. In short, Bowers suggests that the value-based account does not sufficiently justify the inclusion of non-economic interests in the bankruptcy process – it merely points to the fact that some of these interests are included in the present legislation.[215]

One might reject Korobkin's value-based account, as Bowers does, on the grounds that bankruptcy law is primarily concerned with economic questions such as how to divide up the pie amongst creditors. However, this does not rule out an economic account of bankruptcy law that considers a broader set of interests than those of traditional creditors such as lenders. As Bowers notes, economics is concerned with "goods" in the broadest sense, and therefore "there are few, if any, noneconomic values."[216] As such, Bowers' objection does not rule out the sort of bankruptcy system proposed by Karen Gross. Like Korobkin, Gross has argued that a bankruptcy system should account for "community interests", which may be as varied as the preservation of jobs to the quality of life in a town. On this account, even where community interests are not strictly quantifiable, they may still have value and should therefore be considered in the bankruptcy process.[217] Like the value-based account, Gross' approach emphasizes the protection of interests that are not necessarily quantifiable. However, Gross also insists that such a system need not ignore the interests of creditors or make noneconomic choices over economic ones. Instead, Gross advocates a broader understanding of

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[215] *Ibid* at 71.
[216] *Ibid* at 72.
[217] *Ibid* at 1046.

economic interests:[218]

> Taking community interests seriously is *not* synonymous with rejecting all economic modeling; what it reflects is a desire for a different, more expansive economic model. Such a model would account for (value) things not currently considered by the narrow economic paradigm. Finally, considering community does *not* mean that we should always save the buggy whip maker, the euphemism used at the Conference and elsewhere for the company whose need to exist has apparently obsolesced. . ..

This broader definition of economic interests is attractive because it recognizes that restructuring often engages matters of "public interest". However, the concept of the community or public interest is unclear. Additionally, Gross' account does not say how the public interest ought to be weighed against the more narrow economic interests of debtors and creditors.

One solution to the above problem is to accept that bankruptcy law is predicated on economics – broadly defined – without abandoning its redistributive aim. Elizabeth Warren proposes such a system:[219]

> Even if it does not compel specific answers to hard questions, identifying the premise of bankruptcy has a very real impact on how those questions are answered. If the central justification is nothing more than a single economic construct, specific conclusions with systemwide impact follow neatly from an abstract principle. But if the justification for bankruptcy is also distributional, the relevant inquiry is necessarily larger: what are the values to be protected in the distributional scheme, and is the implementation scheme effective?

In Warren's view, bankruptcy law's distributional aims require a consideration of broad normative questions about who suffers when a business fails, as well as who can best bear the costs of failure. These are difficult questions without neat answers. However, Warren sees this approach as preferable to Baird's because it leaves open the possibility that bankruptcy can balance the interests of the debtor, traditional creditors and others "who may be injured by the debtor's collapse."[220] In short, Warren acknowledges that

[218] Karen Gross, "Taking Community Interests Into Account in Bankruptcy: An Essay" (1994) 72 Wash U L Q 1031 at 1033.
[219] Elizabeth Warren, "Bankruptcy Policy" (1987) 54 U Chi L Rev 775 at 796.
[220] *Ibid* at 799.

one aim of bankruptcy is to provide a collective process for debt collection, but asserts that it is not the only measure for justifying the entire bankruptcy system.[221] Indeed, if promoting collectivism were the only aim of bankruptcy, then we should favor a system in which creditor classes are abolished. All creditors would decide collectively whether to sell or keep the collateral depending on which brings more money, and since all creditors would be equal, they would focus only on maximizing the value of the whole estate. Ultimately, this pure collectivist model would be undesirable because it would significantly alter the behaviour of different parties outside the bankruptcy process, impose costs in other areas of the credit system, and pose a serious threat to that system.[222]

Although restructuring theory remains unsettled, Warren's account offers the best compromise between a purely collectivist model that ignores the social and economic consequences of restructuring for non-traditional creditor groups, and a value-based model that ignores the fact that restructuring law still begins with the debtor-creditor relationship. Warren's account recognizes that restructuring law is concerned with economic phenomena such as financing and security, but may also consider broader interests. This account also seems broadly consistent with Janis Sarra's model of restructuring under the CCAA, which is discussed further below.[223] However, if restructuring law ought to consider interests beyond those of traditional creditor groups such as lenders, then it is essential to have some definition of what those broader interests might be. Therefore, it is helpful to consider how the concept of the public interest has

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[221] *Ibid* at 800.
[222] *Ibid* at 804.
[223] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations*, (Toronto: University of Toronto Press, 2003) at 41.

developed in Canadian restructuring law.

(iii) Defining the "Public Interest"

In addition to the separate objective of preserving going concern value, Canadian restructuring law aims to serve the public interest as well. This purpose can be traced back to the CCAA's historical roots. Discussing the CCAA in 1947, Stanley Edwards stated:[224]

> Another reason which is usually operative in favour of reorganization is the interest of the public in the continuation of the enterprise, particularly if the company supplies commodities or services that are necessary or desirable to large numbers of consumers, or if it employs large numbers of workers who would be thrown out of employment by its liquidation. This public interest may be reflected in the decisions of the creditors and shareholders of the company and is undoubtedly a factor a court would wish to consider in deciding whether to sanction an arrangement under the C. C. A. A.

Edwards understands the term "public interest" to include the interests of consumers, investors, labor groups and the general public in the reorganization process.

The Supreme Court of Canada recognized the importance of considering the public interest in a restructuring in *Century Services v. Canada.*[225] Acknowledging the historical roots of the CCAA in the Great Depression, the Supreme Court went on to discuss early cases and commentaries on the Act:[226]

> Early commentary and jurisprudence also endorsed the *CCAA*'s remedial objectives. . . Reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs. Insolvency could be so widely felt as to impact stakeholders other than creditors and employees. Variants of these views resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

Later in its decision, the Supreme Court reiterated that courts must be aware of the interests in restructuring beyond those of debtors and creditors. These might include the

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[224] Stanley E Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) 25 Can Bar Rev 587 at 593.
[225] *Century Services v Canada (Attorney General)*, 2010 SCC 60.
[226] *Ibid* at para 18.

interests of employees, directors, shareholders, and those doing business with the insolvent company.[227] Additionally, there will be cases in which the "*broader public interest* will be engaged by aspects of the reorganization and may be a factor against which the decision to allow a particular action will be weighed."[228]

The Supreme Court's analysis of the public interest in *Century Services* repeatedly cites Janis Sarra's work *Creditor Rights and the Public Interest.*[229] In her work, Sarra considers the question of how to reconcile the interests of debtors and creditors with the public interest. Sarra acknowledges that the public interest is "a nebulous and troublesome concept."[230] However, Sarra suggests that while most judicial decisions in the insolvency context avoid defining the public interest, the term refers to the complex balancing of interests that courts undertake in restructuring. This balancing of interests has given rise to several principles for which the term "public interest" is a short form reference. Sarra summarizes these principles as follows:[231]

- It is in the public interest to:
- avoid premature liquidations – restructuring schemes are a valuable mechanism to prevent them;
- achieve the optimal allocation of costs of firm failure, internally and externally;
- protect the claims of various stakeholders such that there is not a race to enforce individual claims to the detriment of other claimants;
- respect the statutory allocation of priority claims while still allowing parties the

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[227] *Ibid* at para 60.
[228] *Ibid.* Emphasis added.
[229] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003).
[230] *Ibid* at 106.
[231] *Ibid.*

opportunity to determine whether they should compromise or defer those claims in anticipation of generating greater value in the long term;

- enhance access to information about the insolvent firm in order to allow for informed negotiations for an optimal solution;
- generate economic activity and to create a going-forward business strategy that preserves creditors', workers', and other firm-specific economic investments.

In addition to the non-traditional creditor groups mentioned above, such as workers, we may also wish to include pensioners.[232] Significantly, these public interest principles are grounded firmly in measurable economic interests and include the collectivist aim of avoiding the creditors' race to seize the debtor's assets. At the same time, these principles depart from the collectivist account by recognizing that groups beyond traditional creditors make investments in firms and therefore have quantifiable interests in a restructuring. These groups – such as employees and pensioners for example – may be involuntary creditors who lack the leverage or standing of large institutional lenders and cannot negotiate for better protection of their interests in the event of bankruptcy. Clearly, such an approach will have distributional consequences, and this will upset those who wish to protect negotiated pre-bankruptcy entitlements. However, Sarra notes that there are also distributional consequences to a system that "values equity and debt capital to the exclusion of other investments."[233] The key to Sarra's account is that any distributive consequences should be based on quantifiable investments in "human capital,

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[232] Sarra notes in a recent study that unfunded pension liabilities "have been the driver of a significant number of recent *CCAA* filings." Janis Sarra, "Development of a Model to Track Filings and Collect Data for Proceedings Under the *CCAA*", Final Report to the Office of the Superintendent of Bankruptcy Canada (March 2006), online: <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01669.html>. Also, the recent case of *Re Indalex Limited*, 2011 ONCA 265 has highlighted the importance of pensioners' rights in the restructuring context.

[233] *Ibid* at 107.

environmental waiver, capital investment and infrastructure."[234]

Sarra's approach allows for consideration of a broader range of interests in restructuring than the collectivist account. At the same time, her approach does not go so far as to reject the underlying economic-based model for decision-making in the insolvency context. Adhering to the economic-based model – and thus insisting that the "public interest" include only quantifiable investments – provides an important balance for courts in deciding when to favor some interests over others. Any approach advocating consideration of broader interests in restructuring must answer the question of where to draw the line. If restructuring is not all about debtors and creditors, then how do we decide who else should be included, and how do we decide when one interest should prevail over another? Focusing on quantifiable economic investments, broadly defined, is one answer to this problem. In fact, this is not a new idea. It is consistent with the principles of the CCAA and is evident in the early commentaries on the Act. Stanley Edwards emphasized that in making a decision, a CCAA court should have "adequate data as to what factors of public interest are involved."[235] In Edwards' model of CCAA decision-making, these data would be analyzed alongside information about the company's finances, the sale value of its assets, and projected earnings after reorganization. In short, Edwards also understood the public interest in terms of quantifiable investments and he saw the public interest as a core concern of the CCAA, which was designed in response to the economic and social devastation of the Great Depression.[236] For these reasons, Sarra's account of restructuring – and broadly speaking,

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[234] *Ibid* at 108.
[235] Stanley E Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947) 25 Can Bar Rev 587 at 601.
[236] *Ibid* at 590.

Elizabeth Warren's as well – best reflects the underlying purposes of restructuring law.

(iv) Conclusion

This chapter began by examining several competing theories of restructuring law. It discussed the various shortcomings of a narrow economic-based model as well as the value-based model. It then discussed how an economic-based rehabilitation model that permits a broad definition of restructuring's stakeholders, where appropriate, can take into account the public interest without sacrificing the rights of more traditional creditor groups. This model is consistent with the history and purpose of the CCAA as discussed in the first two chapters of this thesis.

The public interest is an important consideration in Canadian restructuring law. Where the public interest might be engaged by some aspect of a restructuring, it behooves counsel and the courts to consider whether the public interest will be helped or harmed by the court's decision. This is especially true of liquidations under the CCAA. As discussed in Chapters I and II, Parliament, commentators and the courts have acknowledged that liquidation can have negative social and economic consequences for a broad constituency of stakeholders. The term "public interest" is essentially a short-form for the interests of these stakeholders. Chapter IV will discuss why the problem of liquidations under the CCAA has not been resolved by the creation of section 36 of the Act, which authorizes the court approval of asset sales. Chapter V will address the problem directly by evaluating the arguments for and against CCAA liquidations in light of the history, purpose and place of the CCAA in Canada's bankruptcy and insolvency regime.

IV. CCAA ASSET SALES AND THE FAILURE OF SECTION 36

(i) Introduction

This chapter examines the process for court approval of asset sales under the CCAA. Although the common law has allowed asset sales with the approval of the supervising judge for some time, the rules on asset sales have been codified only recently in the September 2009 amendments to the CCAA.[237] These amendments introduced a new provision, section 36, which provides guidelines for courts to consider when deciding whether to approve asset sales.[238]

This chapter begins by looking at the key cases on asset sales prior to the 2009 amendments. It then considers the amendments and subsequent cases and commentaries, analyzing the impact of the 2009 amendments on the sale approval process. This analysis leads to a surprising conclusion: in major asset sale cases thus far, courts have largely ignored section 36 as a substantive test for whether to approve asset sales. In some cases, courts have said that section 36 is not a definitive test at all. This is surprising because the Joint Task Force on Business and Insolvency Law Reform and the Standing Senate Committee on Banking, Trade and Finance recommended enacting section 36 to provide "substantive direction" to courts in deciding whether to approve a sale of assets.[239] Despite this recommendation, recent cases suggest that section 36 is only one of many considerations in the approval of asset sales and is not substantive. This will be discussed below in Part (v) of this chapter.

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[237] *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, SC 2007, c 36.

[238] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 s 36.

[239] Senate, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) (Chair: Richard H Kroft) at 146.

A second conclusion is that section 36 has done nothing to resolve the ongoing disagreement among judges and academics over "liquidating CCAAs" – that is, the use of CCAA proceedings to effect the sale of substantially all the assets of a debtor company, often where no plan is presented to creditors and where there is no intention of continuing the debtor company as a going concern. This is unfortunate because the Senate Committee intended that section 36 provide "some guidance with regard to minimum requirements to be met during the sale process."[240] However, section 36 cannot fully resolve the dispute over liquidating CCAAs because it makes no mention of them. Although section 36 has answered a procedural question – do courts have the authority to approve asset sales? – it has not answered the substantive question: under what circumstances, if any, are liquidating CCAAs appropriate? This question is important given the different approaches to liquidating CCAAs in the courts. This will be discussed further in Chapter V.

(ii) Common Law on Asset Sales Prior to the 2009 Amendments

(a) Ontario

In the 1998 decision of *Re Canadian Red Cross Society*,[241] Blair J., as he then was, approved a CCAA sale of substantially all of the assets of the Red Cross. In doing

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[240] Senate, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) (Chair: Richard H Kroft) at 148 (emphasis added).
[241] (1998), 5 CBR (4th) 299 (Ont CJ [Commercial List]).

so, Blair J. held that the supervising judge in a CCAA proceeding had the authority to approve asset sale plans, even before a creditor vote:[242]

> The source of the authority is twofold: it is to be found in the power of the Court to impose terms and conditions on the granting of a stay under section 11; and it may be grounded upon the inherent jurisdiction of the Court, not to make orders which contradict a statute, but to "fill in the gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of a debtor until it can present a plan".

In approving the transaction, Blair J. applied two tests. Firstly, he found that the purchase price was "fair and reasonable" based on the reports of the Monitor, financial advisors, and other independent experts involved.[243] Next, he considered the four "duties" of the Court in approving an asset sale, as established by the Ontario Court of Appeal in *Royal Bank v. Soundair*:[244]

> (i) to consider whether the debtor has made a sufficient effort to obtain the best price and has not acted improvidently
> (ii) to consider the interests of the parties
> (iii) to consider the efficacy and integrity of the process by which offers have been obtained
> (iv) to consider whether there has been unfairness in the working out of the process

Notably, Blair J. applied this test by analogy, since *Soundair* de alt with the requirements for approval of a sale by a court-appointed receiver, not for CCAA sales. Nonetheless, as will be discussed below, *Soundair* has become an important test for CCAA sales since the *Red Cross* decision.

In *Re Tiger Brand Knitting Co*,[245] the Ontario Superior Court of Justice considered an application by the debtor company for an extension of time to negotiate with a prospective purchaser. The offering process for the going concern sale of the company's assets had ended and the Monitor was expected to finalize negotiations with a

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[242] *Ibid* at para 43.
[243] *Ibid* at para 49.
[244] (1991), 7 CBR (3d) 1 (Ont CA); *Re Canadian Red Cross Society* (1998), 5 CBR (4th) 299 (Ont CJ [Commercial List]) at paras 47-48. The *Soundair* factors were laid out originally in *Crown Trust Co v Rosenberg* (1986), 60 OR (2d) 87 (Ont HC).
[245] (2005), 9 CBR (5th) 315 (Ont Sup Ct).

prospective purchaser shortly.[246] C. Campbell J. applied the four factors from *Soundair* and found that they had been satisfied.[247] In doing so, C. Campbell J. stated that the *Soundair* factors "are implicit in a marketing and sale process pursuant to Court Order under the CCAA."[248]

More recently, in *Re Nortel Networks Corp*,[249] the same Court approved a CCAA sale process according to the following factors:[250]

> (a) is a sale transaction warranted at this time?
> (b) will the sale benefit the whole "economic community"?
> (c) do any of the debtors' creditors have a *bona fide* reason to object to a sale of the business?
> (d) is there a better viable alternative?

These factors have become known as the *Nortel* criteria. As will be discussed below in Part (iv) of this chapter, these criteria apply to the approval of a CCAA sale process – such as an auction – in the absence of a restructuring plan. They do not apply to the approval of the final sale transaction at the conclusion of the auction. However, in approving the sale process in *Re Nortel Networks*, the Court noted that the debtor would "aim to satisfy the elements established by the court for approval as set out in *Royal Bank v. Soundair Corp.*"[251] In a subsequent hearing at the conclusion of the auction process, the Court applied the *Soundair* factors, found that they had been satisfied, and approved the final sale. In doing so, Morawetz J. stated:[252]

> Although the *Soundair* and *Crown Trust* tests were established for the sale of assets by a receiver, the principles have been considered to be appropriate for sale of assets as part of a court supervised sales process in a CCAA proceeding.

(b) Québec

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[246] *Ibid* at paras 15-16.
[247] *Ibid* at paras 34-37.
[248] *Ibid* at para 35.
[249] (2009), 55 CBR (5th) 229 (Ont Sup Ct).
[250] *Ibid* at para 49.
[251] *Ibid* at para 53.
[252] *Re Nortel Networks Corp*, 56 CBR (5th) 229 (Ont Sup Ct) at paras 34-36.

Québec courts have not applied *Soundair* directly in all CCAA asset sale cases, but their decisions often reference *Soundair* and consider the factors indirectly when determining whether to approve sales.

In *Les Boutiques San Francisco*,[253] the Québec Superior Court approved a CCAA sale where the bank syndicate and Monitor supported it, the sale price was the best possible price at the end of the sale process and was greater than the liquidation value of the company, and the sale would allow most employees to keep their jobs.[254] These factors appear to overlap with the *Soundair* factors, though *Soundair* was not cited in the decision.

In *Re Mecachrome Canada Inc*,[255] the same Court refused to approve a plan in which interim (DIP) lenders would acquire all the shares of the debtor company where the debtor had failed to properly canvass the market for bidders.[256] The Court cited *Soundair* and *Tiger Brand Knitting* but did not apply the *Soundair* test directly:

> As stated, albeit in a different but still similar context, by the Ontario Court of Appeal in *Soundair*, by the Ontario Superior Court of Justice in *Tiger Brand Knitting*, by the Alberta Court of Queen's Bench in *Calpine Canada Energy Ltd., Re,* and by this Court…in a process such as this one, there has to be some demonstration by the Canadian Debtors that reasonable attempts have been made to properly canvass the market before approving a PFA that is, in essence, presented to the affected creditors as the best available deal under the circumstances.

In *Re Rail Power Technologies Corp*,[257] the Court applied the *Soundair* test in approving the sale of substantially all of the debtor company's assets.[258] In doing so, the Court emphasized that the Monitor had recommended the sale:[259]

> The issue of unfairness in the process identified in Soundair, concerns actions of the

[253] (2004), 5 CBR (5th) 197 (Qc Sup Ct).
[254] *Ibid* at para 3.
[255] *Re Mecachrome Canada Inc* (2009), 58 CBR (5th) 49 (Qc Sup Ct).
[256] *Ibid* at para 45.
[257] 2009 QCCS 2885.
[258] *Ibid* at para 51.
[259] *Ibid* at para 93, citing *Re Winnipeg Motor Express Inc*, 2008 MBQB 297 at para 24.

> receiver typically towards a potential purchaser. As long as the receiver has acted reasonably prudently, fairly and not arbitrarily, its recommendation should be accepted.

(c) Alberta

In *Royal Bank v. Fracmaster Ltd.*,[260] the Alberta Court of Appeal upheld the lower court's decision to appoint a receiver instead of using the CCAA to sell substantially all the assets of the debtor company. The Court of Appeal held that a sale of assets under the CCAA should only occur where the proposed transaction is "in the best interests of the creditors generally" and that this requirement was not met by the sale of substantially all of the debtor's assets with no continued involvement by creditors and shareholders.[261] In contrast to the Ontario and Québec approaches to CCAA sales, the Court also distinguished between CCAA and receivership proceedings, stating that a CCAA judge must wait for creditor approval before sanctioning a plan:[262]

> Under the CCAA the court has no discretion to sanction a plan unless it has been approved by a vote of 2/3 majority in value of each class of creditors (section 6). To that extent, each class of creditors has a veto. This procedure is quite different from a court-appointed receivership. In a receivership the desires of the creditors are a significant factor, but the approval by a specific majority of creditors is not a pre-condition to court sanction, and creditors do not have an absolute veto. The difference in the procedures gives rise to different tests and considerations to be applied in each type of proceeding. While in this case the lending syndicate's desires in the CCAA and receivership proceedings were consistent, the chambers judge was not required to give the same weight to their wishes in each proceeding.

In reaching its decision, the Court of Appeal applied the *Soundair* test to the receiver's proposed sale.[263]

In *Re 843504 Alberta Ltd.*,[264] the Alberta Court of Queen's Bench refused to approve a CCAA sale of substantially all of the debtor company's assets before the Monitor had presented a formal plan to the creditors. The Court did not apply the

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[260] (1999), 11 CBR (4th) 230 (Alta CA).
[261] *Ibid* at para 16.
[262] *Ibid* at para 14.
[263] *Ibid* at para 32.
[264] (2003), 4 CBR (5th) 306 (Alta QB).

Soundair test to the proposed sale. Instead, the Court cited *Fracmaster* and distinguished the Ontario Superior Court decision in *Red Cross*, stating:[265]

> Simply put, in this province the corporate entity is expected to continue in some form or another unless there are exceptional circumstances. Liquidation proceedings are typically reserved for receiverships, windings up or bankruptcy. . .This is quite different than in Ontario where apparently debtors can use the benefits of the legislation when there is no prospect of corporate survival or no plan of arrangement is proposed.

Despite the above cases, in *Re CalpineCanada Energy Ltd.*,[266] Romaine J. of the Alberta Court of Queen's Bench applied the *Soundair* test in a DIP financing sale under the CCAA despite the fact that *Soundair* was a case dealing with a receivership:[267]

> While the *Soundair*case involved a receivership and this is a situation of a debtor-in-possession under the CCAA overseen by a Monitor, these duties remain relevant to the issues before me, with some adaptation for the differences in the form of proceedings.

The Court in *Calpine* gave final approval to the plan following the satisfaction of previously imposed conditions intended to ensure fairness and transparency in the sale negotiation process.[268] The Court emphasized that the Monitor supported the plan and that this was an important factor in determining whether to approve it, as expressed in *Crown Trust Co. v. Rosenberg*:[269]

> If the court were to reject the recommendations of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

(d) British Columbia

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[265] *Ibid* at paras 14-15.
[266] 2007 ABQB 49.
[267] *Ibid* at para 29.
[268] *Ibid* at paras 31-34.
[269] (1986), 39 DLR (4th) 326 (Ont HC) at 112, cited in *Re Calpine Canada Energy Ltd*, 2007 ABQB 49 at para 52. This statement was adopted by the Ontario Court of Appeal in *Royal Bank v Soundair* (1991), 7 CBR (3d) 1 (Ont CA) at para 21.

Courts in British Columbia generally will refuse to approve CCAA sales involving substantially all the assets of the debtor company where a plan has not been presented to the creditors. In *Cliffs Over Maple Bay*,[270] the British Columbia Court of Appeal reversed the CCAA supervising judge's decision granting a stay of proceedings under section 11 that would have allowed the debtor company to restructure and obtain DIP financing without presenting a plan to its creditors. Tysoe J.A. stated that while the filing of a draft plan of arrangement was not a prerequisite for obtaining a stay under section 11, a stay should not be granted where the debtor company has no intention to present a plan to its creditors.[271] Notably, the Court of Appeal made its decision despite the Monitor's support for the plan.[272] In *obiter*, Tysoe J.A. stated:[273]

> I need not decide the point on this appeal, I query whether the court should grant a stay under the *CCAA* to permit a sale, windingup or liquidation without requiring the matter to be voted upon by the creditors if the plan of arrangement intended to bemade by the debtor company will simply propose that the net proceeds from the sale, winding up or liquidation be distributedto its creditors.

While Tysoe J.A. made no reference to a specific case, this *obiter* clearly questions the Ontario approach of allowing a CCAA sale of substantially all of the debtor company's assets before a plan is presented to the creditors.

(e) Conclusions on the Common Law Relating to Asset Sales Prior to 2009

The above cases demonstrate that there is a divergence in judicial approaches to the approval of CCAA asset sales between courts in Ontario and Québec, on the one hand, and courts in Alberta and British Columbia, on the other. With some exceptions, Western courts are less likely to approve sales in which the debtor company will not present a plan to its creditors and will not continue as a going concern after restructuring.

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[270] *Cliffs Over Maple Bay Investments Ltd v Fisgard Capital Corp*, 2008 BCCA 327.
[271] *Ibid* at para 31.
[272] *Ibid* at paras 14-15.
[273] *Ibid* at para 32.

Their rationale is that these sorts of sales are liquidations, and it is generally inappropriate to use the CCAA in such cases when the sales can be completed through a receivership.

The use of the *Soundair* factors in CCAA sales, factors that were intended to apply to sales by receivers, is less than ideal from a theoretical perspective because the CCAA is a restructuring statute. As will be discussed further in Chapter V, the distinction between restructuring and liquidation is important. Significantly, in *Cliffs Over Maple Bay*, the British Columbia Court of Appeal stated that courts should not grant CCAA protection to a debtor company that "does not intend to propose a compromise or arrangement to its creditors."[274] Likewise, the Alberta Court of Appeal in *Fracmaster* expressed the view that liquidations should not occur under the CCAA in most circumstances:[275]

> There must be an ongoing business entity that will survive the asset sale. . . A sale of all or substantially all the assets of a company to an entirely different entity, with no continued involvement by former creditors and shareholders, does not meet this requirement. While we do not intend to limit the flexibility of the CCAA, we are concerned about its use to liquidate assets of insolvent companies which are not part of a plan or compromise among creditors and shareholders, resulting in some continuation of a company as a going concern. Generally, such liquidations are inconsistent with the intent of the CCAA and should not be carried out under its protective umbrella.

It is unsurprising that the above cases make no mention of *Soundair* in the context of CCAA sales because *Soundair* applies to liquidations by receivers. If wholesale liquidations should not occur under the CCAA – as *Cliffs* and *Fracmaster* suggest – then *Soundair* is not particularly relevant in the context of CCAA sales.

It makes sense that courts considering CCAA liquidations would turn to the *Soundair* factors, since until recently *Soundair* provided the only guidance. However, with Parliament adding section 36, courts are granted the express authority to approve

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[274] *Ibid* at para 31.
[275] *Royal Bank v Fracmaster Ltd* (1999), 11 CBR (4th) 230 (Alta CA) at para. 16.

asset sales under the CCAA and are instructed to consider specific factors. In light of this, one might think that courts would come to favour the section 36 factors over those of *Soundair*. As will be discussed below, this has not come to pass, and the result has been a series of muddled analyses in Ontario and Québec in which the courts have considered different combinations of *Soundair*, section 36 and other factors. It remains to be seen whether Western courts will do the same, or whether they will simply focus on section 36 when asked to approve asset sales under the CCAA.

(iii) The 2009 Amendments: Section 36 of the CCAA

(a) The Text of Section 36

Coming into force on September 18, 2009, section 36 is a new provision granting the CCAA court express jurisdiction to authorize asset sales in restructuring proceedings. Subsection (1) requires that a debtor company obtain court authorization before selling assets outside the ordinary course of its business in a restructuring. Additionally, subsection (2) requires that the debtor company notify all secured creditors who are "likely to be affected by the proposed sale." Subsection (3) lists several factors that the court must consider in deciding whether to authorize a sale:

> (3) In deciding whether to grant the authorization, the court is to consider, among other things,
> (*a*) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
> (*b*) whether the monitor approved the process leading to the proposed sale or disposition;
> (*c*) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;
> (*d*) the extent to which the creditors were consulted;
> (*e*) the effects of the proposed sale or disposition on the creditors and other interested parties; and
> (*f*) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

Importantly, this is a non-exclusive list, as subsection (3) provides that the court is to consider these factors "among other things." These additional considerations will be

examined in the following section. It is also noteworthy that the Monitor is not formally required to file a report in respect of a proposed sale, despite subsections (3)(b) and (c) asking the court to consider the Monitor's opinion.[276]

Subsection (4) provides that where the proposed sale is to a "related party,"[277] the court must first consider the factors in subsection (3) and then be satisfied that:

> (*a*) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and
> (*b*) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

(b) The Purpose of Section 36

In its report, *Debtors and Creditors Sharing the Burden*, the Standing Senate Committee on Banking, Trade and Commerce suggested that the section 36 amendments were intended to provide courts with "substantive direction" on factors to consider when deciding whether to approve asset sales.[278] In discussing the purpose of section 36 with regard to the sale process, the Committee stated:[279]

> [T]here are circumstances where all stakeholders would benefit from the opportunity for an insolvent company involved in a reorganization to divest itself of all or part of its assets, whether to raise capital, eliminate further loss for creditors or focus on the solvent operations of the business. We feel, however, that the Court must be involved in approving such sales and that it should be provided with some guidance regarding minimum requirements to be met during the sale process.

The Committee did not mention *Soundair* in its brief discussion of asset sales and there is no suggestion that section 36 was intended to replace the common law approach of

[276] The CBA recommended that the Monitor be required to file a report in respect of a proposed sale in its written submission on Bill C-55 to the House Committee in November 2005, at 44. Available online: <www.cba.org/cba/submissions/pdf/05-52-eng.pdf>. See also E Patrick Shea, *Bankruptcy & Insolvency Act, Companies' Creditors Arrangement Act, Bill C-55 & Commentary* (Toronto: LexisNexis 2006).

[277] A "related party" is defined in subsection (5) as:

(*a*) a director or officer of the company;
(*b*) a person who has or has had, directly or indirectly, control in fact of the company; and
(*c*) a person who is related to a person described in paragraph (*a*) or (*b*).

[278] Senate, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) (Chair: Richard H Kroft) at 146.

[279] Emphasis added. *Ibid* at 146-147.

applying the *Soundair* criteria. However, the Committee seems to have expected that the section 36 factors would constitute "minimum requirements" that debtor companies would have to meet when asking for court approval of asset sales under the CCAA. In other words, while the amendments should not be read to preclude *Soundair*, section 36 was intended to be substantive. Surprisingly, the recent treatment of section 36 in Ontario and Québec does not reflect this intention. This is discussed below.

(iv) The Impact of the 2009 Amendments on Judicial Approaches to Asset Sales

(a) When Will Courts Apply Section 36?

Despite the Senate Committee's intention that section 36 provide substantive direction to courts in approving asset sales, the interpretations of section 36 by courts so far suggests that section 36 is not substantive. This has created uncertainty in the judicial analysis of asset sales.

In *Re Canwest Global Communications Corp*,[280] the first in a series of proceedings dealing with section 36, Pepall J. of the Ontario Superior Court considered the circumstances in which the section 36 criteria would apply to a proposed sale of assets. Firstly, in order for section 36 to be engaged, the threshold requirements must be met:[281]

> Court approval is required under section 36 if:
>
> (a) a debtor company under CCAA protection
>
> (b) proposes to sell or dispose of assets outside the ordinary course of business.

Pepall J. made two important holdings with respect to these threshold requirements. Firstly, she held that while partnerships are not expressly included in the definitions of "debtor company" and "company" in subsection 2(1) of the CCAA, section 36

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[280] 2009 CarswellOnt 7169 (Ont Sup Ct).
[281] *Ibid* at para 26.

nonetheless applied to the partnerships that were under CCAA protection in *Canwest*.[282] This holding should be viewed within the fact-specific context of the *Canwest* proceedings. The limited partnerships in *Canwest* were highly integrated with those of the debtor companies under CCAA protection. Therefore, Peppall J. reasoned that even though the partnerships were not "debtor companies" under the CCAA, the Court had inherent jurisdiction to extend CCAA protection to the partnerships. This analysis is less than ideal because it provides no clear rule for when a partnership will enjoy CCAA protection, but it is nonetheless in line with previous Ontario decisions in which courts have extended CCAA protection to entities that do not fall within the definition of a CCAA "debtor company" where those entities are highly integrated with a debtor company or companies undergoing restructuring.[283]

Secondly, Pepall J. held that when determining whether a proposed sale was in the "ordinary course of business" within the meaning of section 36, a court should conduct a fact specific inquiry:[284]

> [A] court should in each case examine the circumstances of the subject transaction within the context of the business carried on by the debtor.

In her decision, Pepall J. held that section 36 did not apply to the transfer of shared assets and services in an "internal reorganization transaction" within the same corporate family.[285] In Peppall J.'s view, it would have been "commercially unreasonable" to expect the debtor companies to satisfy the requirements of section 36(4) for sales to third parties because of the "highly integrated and interdependent" businesses of the parties.[286] The Canwest family of entities had previously adopted a complex business structure for

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[282] *Ibid* at para 30.
[283] See especially *Re Lehndorff General Partner Ltd* (1993), 17 CBR (3d) 24 (Ont Sup Ct).
[284] *Re Canwest Global Communications Corp*, 2009 CarswellOnt 7169 (Ont Sup Ct) at para 35.
[285] *Ibid* at para 36.
[286] *Ibid.*

tax reasons that no longer applied, and the proposed transactions would merely "realign the shared services arrangements" between these entities.[287] As such, Pepall J. was careful to note that not all internal reorganizations would fall outside the purview of section 36.[288]

The above analysis of when section 36(4) should apply makes sense based on the specific facts of *Canwest*, but the implications for section 36 are troubling. The 2003 Senate report states that sales to related parties should not be permitted other than in "exceptional circumstances."[289] Perhaps transfers between highly integrated entities undergoing restructuring should be exempt because they are exceptional circumstances, but this requires further inquiry. Instead, Pepall J. relied simply on a statement by Industry Canada that section 36(4) was intended to address the problem of "phoenix corporations", i.e. companies whose owners engage in serial bankruptcies in order to purchase assets of the bankrupt business through a new entity and leave creditors unpaid.[290] This ignores the fact that related parties may have other interests in asset sales beyond "phoenix corporation" schemes – for example, incumbent management simply might be trying to entrench itself by devising a new internal structure for the corporate family.

Pepall J. went on to say that even where a proposed sale is outside the ambit of section 36 because it is in the ordinary course of business, section 36 "may be considered in assessing fairness" where the sale is to a related party.[291] On this account, courts in

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[287] *Ibid.*
[288] *Ibid* at para 35.
[289] Senate, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) (Chair: Richard H Kroft) at 148.
[290] *Ibid* at para 34.
[291] *Ibid* at para 37.

such cases should consider, at a minimum, whether the proposed sale is fair and facilitates the restructuring. On this basis, Pepall J. then applied the provisions of section 36 to the proposed sale and found that they had been satisfied.[292] As a consequence of this analysis, it now appears that courts have the discretion to decide when to apply section 36 to proposed related party sales. In effect, Pepall J. substituted a test of whether the proposed transaction is "fair and facilitates the restructuring" in place of the clear wording of section 36(4):

> (4) If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that
>
> (*a*) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and
>
> (*b*) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

In the third *Canwest* proceeding,[293] Pepall J. held that section 36 did not apply to transfers contemplated by a restructuring plan because the plan as a whole was subject to court approval. In that case, the asset transfers contemplated had been approved by a vote of the affected creditors.[294] This suggests that section 36 applies only to asset sales in the absence of a restructuring plan. This holding is problematic in light of the view expressed by Western courts that the CCAA should not be used to effect liquidations in the absence of a formal plan.[295] While it remains to be seen how Western courts will apply section 36, it seems unlikely that they will interpret it in the same manner as the Court in *Canwest*.

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[292] *Ibid* at para 38.
[293] (2010), 70 CBR (5th) 1 (Ont Sup Ct).
[294] *Ibid* at para 27.
[295] *Cliffs Over Maple Bay Investments Ltd v Fisgard Capital Corp*, 2008 BCCA 327 at para 32.

In *Re Brainhunter*,[296] a recent decision of the Ontario Superior Court, Morawetz J. approved a "stalking horse"[297] bid process where the purchaser was a related party and an insider of the company, without applying section 36 of the CCAA. Morawetz J. held that section 36 is engaged only where the court is asked to approve an "actual sale" of assets. Approval of an "actual sale" was to be distinguished from approval of a "sale process" such as an auction.[298] Accordingly, Morawetz J. did not apply section 36 to determine if the proposed sale process was appropriate, relying instead on the common law test laid out in *Re Nortel Networks Corp.*[299]

There are at least three problems with the above analysis in *Brainhunter*. Firstly, despite holding that section 36 is not engaged in the approval of a sale process, Morawetz J. stated that section 36 "should also be considered indirectly when applying the Nortel Criteria."[300] Unfortunately, the Court did not expand on this point. Presumably, section 36 should be considered indirectly at the process stage because it will apply eventually when the court must decide whether to approve the final sale. In *Nortel*, for example, Morawetz J. considered it important that the debtor would "aim to satisfy" the *Soundair*

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[296] *Re Brainhunter Inc* (2009), 62 CBR (5th) 41 (Ont Sup Ct).

[297] A common arrangement in US bankruptcy law and prevalent in cross-border proceedings, this involves an auction in which the seller designates a "stalking horse" buyer who has the right to bid first in the auction, setting a minimum price that precludes low-ball offers. If the stalking horse is out-bid by subsequent bidders, it typically receives a previously agreed-upon break-fee from the seller for its expenses. It is not a legal term of art as such, but stalking horses have been used in several recent cases. See *Re Nortel Networks Corp* (2009), 56 CBR (5th) 224 (Ont Sup Ct) as an example of a sales process involving a stalking horse auction.

[298] *Re Brainhunter Inc* (2009), 62 CBR (5th) 41 (Ont Sup Ct) at paras 16-17.

[299] (2009), 55 CBR (5th) 229 (Ont Sup Ct). The court's authority to approve a sale process is derived from its general statutory discretion. In deciding whether to approve a sale process, the *Nortel* criteria require the court to consider:

(a) Is a sale transaction warranted at this time?
(b) Will the sale benefit the whole "economic community"?
(c) Do any of the debtors' creditors have a *bona fide* reason to object to a sale of the business?
(d) Is there a better viable alternative?

[300] *Ibid* at para 16.

factors for approval of the final sale in its conduct during the sale process.[301] Moreover, in the earlier decision of *Tiger Brand Knitting*, discussed above, C. Campbell J. of the Ontario Superior Court stated that the *Soundair* factors "are implicit in a marketing and sale process pursuant to Court Order under the CCAA."[302] This suggests that both *Soundair* and section 36 are "implicit" in the approval of a sale process under the *Nortel* criteria. However, exactly what this means for the judicial analysis is unclear. Is it sufficient for approval of the sale process, as it was in *Nortel*, that the debtor merely "aim[s] to satisfy" the criteria for court approval of the final sale?

The second problem is that the section 36 criteria are tied up with the asset sale process and the *Nortel* criteria. Specifically, subsection 36(3) asks (a) whether the process leading up to the proposed sale was reasonable, and (b) whether the Monitor approved the process. These questions are also fundamental to the court's analysis in deciding whether to approve the sale process. Under the *Nortel* criteria, the court must ask whether the sale transaction is warranted. Often, this analysis includes a consideration of the Monitor's recommendation with respect to the proposed process and whether the process is fair and reasonable. Therefore, by the time the court directly applies section 36 to the final sale transaction, it has decided its answers to questions (a) and (b) already at the process approval stage. This is problematic because the Senate Committee stated that section 36 was meant to provide "substantive direction" to the courts. Since some of the main questions asked by section 36 will be answered already under the *Nortel* criteria, it is difficult to see how section 36 can provide substantive direction.

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[301] *Re Nortel Networks Corp* (2009), 55 CBR (5th) 229 (Ont Sup Ct).
[302] *Re Tiger Brand Knitting Co* (2005), 9 CBR (5th) 315 (Ont Sup Ct) at para 35.

The third, related problem is that it is difficult to imagine many cases where a court would hold that section 36 has not been satisfied at the conclusion of a sale process approved under the *Nortel* criteria. Where the participants have followed the process as sanctioned by the court and the Monitor recommends the final sale, it is a practical impossibility for the court to refuse. In short, once the court sanctions and sets in motion the sale process, the most important test has been met already. Since section 36 is only considered indirectly at this initial stage, if at all, section 36 can provide neither the substantive direction nor the minimum requirements that the Senate Committee intended.

(b) What Additional Factors Will the Court Consider?

Since section 36 provides a non-exhaustive list of factors to consider, courts have considered other factors in determining the appropriateness of sale proposals. In the second *Canwest* decision,[303] Pepall J. approved the sale of substantially all of the financial and operating assets of the Canwest limited partnership entities. Pepall J. applied both section 36 and the *Soundair* criteria to the proposed sale because section 36 had not yet come into force. However, the Court took the approach that section 36 had not changed the analysis very much and that it was quite similar to *Soundair,* stating "[i]ndeed, to a large degree, the criteria overlap."[304] Consequently, it is unclear exactly which factors must be satisfied in order to obtain court approval of a sale. Section 36 has not replaced the *Soundair* factors and evidently, courts may still give serious consideration to the *Soundair* factors when asked to approve asset plans. As discussed below, this is problematic.

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[303] (2010), 68 CBR (5th) 233 (Ont Sup Ct).
[304] *Ibid* at para 13.

In *Re White Birch Paper*,[305] the Québec Superior Court approved the sale of substantially all the assets of a debtor company in a "stalking horse" bid process where all of the preliminary steps of the process had been approved without objection from the interested stakeholders.[306] In his reasons, Mongeon J.C.S. applied the criteria for court approval of asset sales in section 36 and found that they had been satisfied. In doing so, Mongeon J.C.S. stated:[307]

> The elements which can be found in Section 36 CCAA are, first of all, not limitative and secondly need not be all fulfilled in order to grant or not grant an order under this section.
>
> The Court has to look at the transaction as a whole and essentially decide whether or not the sale is appropriate, fair and reasonable. In other words, the Court could grant the process for reasons other than those mentioned in Section 36 CCAA or refuse to grant it for reasons which are not mentioned in Section 36 CCAA.

Citing *Canwest*,[308] the Court went on to say that it was not necessary for approval of a plan that all classes of creditors will benefit, and that the Court "must rely" on the Monitor's recommendation of whether to support the plan.[309] Mongeon J.C.S. then applied the *Nortel* criteria to the sale process and found that they had been satisfied.[310] In effect, the Court determined that section 36 was not the substantive test for approving the asset sales and substituted its own test, asking whether "the sale is appropriate, fair and reasonable."[311]

Based on the above cases, the exact role of section 36 remains unclear. There is overlap between the section 36 and *Soundair* criteria, but they are not the same. Additionally, it is unclear what should happen if a court finds that the *Soundair* criteria

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[305] *Re White Birch Paper Holding Co*, 2010 QCCS 4915.
[306] *Ibid* at para 25. The only objections came from two construction lien holders, whose objections became moot by the time of the final order approving the sale, as separate agreements had been made to honour these claims.
[307] Emphasis added. *Ibid* at paras 48-49.
[308] *Re Canwest Global Communications Corp.* (2010), 68 CBR (5th) 233 (Ont Sup Ct) at para 13.
[309] *Re White Birch Paper Holding Co*, 2010 QCCS 4915 at paras 51-52.
[310] *Ibid* at paras 53-54.
[311] *Ibid* at para 49.

have been satisfied, but the section 36 criteria have not. If section 36 is intended to be substantive, then the analysis in an asset sale approval proceeding should focus on section 36. It may be acceptable to consider the *Soundair* criteria or other factors in these proceedings, but the section 36 criteria are the minimum requirements that must be met. However, the above cases suggest that the opposite is true. Section 36 will be read narrowly so as not to apply in many cases, or so that only some section 36 criteria apply. Meanwhile, the *Soundair* criteria, a "fairness and reasonableness" test or some other criteria might apply instead.

(v) Ongoing Problems Related to Section 36

(a) Asset Sales Generally

While courts in other provinces have not yet had the opportunity to comment, Ontario and Québec courts have recognized at least three different sets of criteria for determining the appropriateness of asset sales in the restructuring context. As discussed above, this is problematic. In short, the current approach to asset sales in these provinces suggests that section 36 cannot provide the substantive direction that the Senate Committee and the Joint Task Force intended when they recommended the new provision in 2003.[312] Nor is the holding in *White Birch* that the section 36 factors "need not be all fulfilled"[313] to approve a sale consistent with the intention – again expressed in the Senate Report – that section 36 provide some minimum requirements that must be met before a court can approve an asset sale.[314]

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[312] Senate, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) (Chair: Richard H Kroft) at 146.
[313] *Re White Birch Paper Holding Co*, 2010 QCCS 4915 at para 48.
[314] Senate, Standing Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) (Chair: Richard H Kroft) at 148

Courts and commentators often praise the flexibility of the CCAA regime. Flexibility is a useful feature of a restructuring regime involving large, complex companies. However, where Parliament has provided clear, substantive direction on asset sales, courts should pay heed. Unfortunately, it seems that the addition of section 36 has served only to make an already complex legal analysis less clear. If the current situation persists, Parliament will need to introduce further amendments to resolve the confusion. For example, the sale approval process could be streamlined by amending section 36 to include a modified set of the *Soundair* factors, with changes where necessary to reflect the different circumstances of restructuring and receivership sales. Parliament also might specify in the Act that section 36 is a substantive test that lays out minimum requirements for CCAA sales. Until this is done, both sets of criteria – and perhaps other factors – will remain applicable, and no clear rule will govern.

(b) The Liquidation vs. Reorganization Debate: Still Alive And Well

The advent of section 36 has not resolved the controversy over "liquidating CCAAs" – the use of CCAA proceedings to effect a sale of assets by the debtor company with no intention of continuing the debtor company as a going concern. Section 36 makes no mention of liquidating CCAAs. However, as the above cases illustrate, courts in Ontario and Québec have continued to approve liquidating plans under the CCAA. Meanwhile, courts in Alberta and British Columbia have expressed skepticism of liquidating CCAAs, especially where no plan is presented to the creditors and where it does not appear that the business operations of the debtor company will continue following liquidation.

Prior to the 2009 amendments introducing section 36, one commentator – now a judge of the British Columbia Supreme Court – noted:[315]

> The amendment will no doubt resolve the question of jurisdiction regarding asset sales, but will not resolve how the court ought to exercise its discretion. . .Further, the amendment does not address procedural questions such as whether a Plan of Arrangement approving the sale must be voted upon by its creditors before any sale takes place. This issue was raise by Tysoe J.A. in *Cliffs Over Maple Bay*, and again goes to the fundamental issue of whether the creditors and the court must endorse a substantive course of action proposed by the debtor company under the *CCAA* instead of the asset liquidations being presented to the creditors as a *fait accompli*.

As these remarks suggest, the debate over liquidating CCAAs raises fundamental questions about the underlying policy goals of Canada's restructuring regime. Section 36 does not solve the problem, because while the provision recognizes that going concern sales may be appropriate in some cases, it does not specify when courts should approve these sales or whether other types of liquidating CCAAs are appropriate. This is a question about the limits of judicial discretion under the CCAA, and it can only be answered by considering the purpose of the statute as a whole.

(vii). Conclusion

While section 36 was intended to provide substantive direction and guidance on minimum requirements for approving CCAA asset sales, courts have continued to apply other common law tests such as *Soundair*. Consequently, section 36 has had the opposite effect than intended: it further complicates the judicial analysis. This problem will remain unresolved until Parliament or the Supreme Court of Canada lays down a clear rule to streamline the sale approval process.

Moreover, section 36 has not resolved the dispute over whether liquidating CCAAs are appropriate, and under what circumstances. As discussed both in this and previous

[315] Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" (2008) *Annual Review of Insolvency Law* 33 at 44-45.

chapters, this problem has divided the courts of the different provinces. It is a fundamental problem because it depends on the interpretation of the underlying purposes of the CCAA.

Chapters I and II examined the legislative history and key cases of the CCAA. Chapter III considered the purposes of the CCAA in the context of different competing theories of restructuring. This chapter discussed why the addition of section 36 to the CCAA has not resolved the problem of liquidating CCAAs. Finally, in the following chapter, the problem of liquidating CCAAs will be examined directly in light of the analysis thus far.

V. LIQUIDATING CCAAs AND THE PURPOSE OF RESTRUCTURING IN CANADA

(i) Introduction

This chapter considers the appropriateness of "liquidating CCAAs." A liquidating CCAA has generally become known as the use of CCAA proceedings to effect the sale of substantially all the assets of a debtor company, often with no plan presented to creditors and no intention of continuing the debtor company as a going concern. As discussed in the previous chapter, although section 36 of the CCAA was intended to provide substantive direction to courts in approving CCAA sales, this aim has not been achieved. Meanwhile, there is ongoing controversy both within the courts and in the academic commentary as to whether and when liquidating CCAAs are appropriate. Section 36 cannot resolve this controversy because it makes no mention of liquidating CCAAs, nor do the general provisions of the CCAA offer helpful guidance in this respect. Nonetheless, the issue must be examined in light of the diverging judicial approaches to liquidating CCAAs.

(ii) Liquidating CCAAs and the Context of the Debate

The term "liquidating CCAA" has not been clearly defined. The CCAA itself makes no mention of liquidations and section 36 does not distinguish between different types of asset sale plans. However, commentators agree that the term might apply to several different types of sales.[316] For example, a liquidation could mean the sale of substantially all of the debtor company's assets to: (a) a single buyer who intends to continue the business operations of the debtor company; (b) many buyers who intend to continue different parts of the business operations, or (c) many buyers who have no

[316] Bill Kaplan, "Liquidating CCAAs: Discretion Gone Awry?" [2008] Ann Rev of Insol L 79 at 86.

intention of continuing the business operations of the debtor company.[317] It is helpful to consider these scenarios along a spectrum from least to most objectionable. Although the debtor company often will cease to exist in all three scenarios, a liquidating CCAA in which the underlying business operations of the debtor continue – leaving in place jobs and existing relationships with customers and suppliers – is less objectionable than one in which the underlying business ceases. This is because part of the purpose of the CCAA is to avoid the negative social and economic consequences of bankruptcy, such as the loss of jobs.[318] However, the liquidating CCAA is still to be distinguished from a restructuring in which the debtor company continues as a going concern, albeit after selling off some assets, downsizing its business operations, or arranging a new financing structure.[319]

In the United States, there has been much debate over whether courts should approve liquidations under Chapter 11, the corporate reorganization provisions of the *Bankruptcy Code*.[320] In particular, Baird and Rasmussen have argued that liquidations under Chapter 11 are now the norm in U.S. bankruptcy proceedings.[321] According to this argument, corporate reorganizations have changed fundamentally in recent years and new reform efforts should focus on maximizing value in liquidations rather than on stopping the practice:[322]

> The debate over speedy sales of all the assets of the business as a going concern is over. Sales are the norm in large reorganizations that are anything other than a confirmation of

[317] Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" [2008] Ann Rev of Insol L 33.
[318] The question of whether existing jobs and relationships will be saved has been an important factor for courts that have approved liquidating CCAAs. For example, see *Les Boutiques San Francisco* (2004), 7 CBR (5th) 189 (Qc Sup Ct).
[319] In Alberta, for example, courts continue to distinguish between liquidating CCAAs, in which the business survives, and restructurings, in which the company and business both survive. See *Royal Bank v Fracmaster Ltd* (1999), 11 CBR (4th) 230 (Alta CA) at paras 15-16.
[320] 11 U.S.C. (2009).
[321] Douglas G Baird and Robert K Rasmussen, "Chapter 11 at Twilight" (2003) 56 Stan L Rev 674 at 675.
[322] Douglas G Baird, "Car Trouble", John M Olin Law & Economics Working Paper No 551 at 2. Available online: <http://ssrn.com/abstract=1833731>.

a debt restructuring reached outside of bankruptcy. The debate now centers on how sales should be conducted.

Baird and Rasmussen rely on empirical evidence demonstrating that liquidation is now the norm in large reorganizations. However, it is important to note that the above statement is based on one study of large U.S. reorganizations in 2002. Given the long history of restructuring, and the fact that several years have passed since this study, these findings cannot indicate a general trend. Having said this, many recent large reorganizations in both the U.S. and Canada have been liquidations, so there is some evidence to support Baird and Rasmussen's claim.

Unfortunately, a comprehensive study on this question has not been conducted in Canada because a database of CCAA proceedings has only become available recently.[323] However, a number of large liquidating CCAAs have occurred in recent years, including those of Nortel Networks,[324] Canwest Global[325] and Indalex.[326] These cases suggest that the CCAA process is now driven primarily by the secured creditors to maximize their own returns. However, if true, this trend would be inconsistent with the CCAA's historical purpose as well as a number of recent cases. Although early restructuring legislation focused on the rights of traditional creditors such as banks, the CCAA has been concerned with the broader interests of employees and other non-traditional stakeholders since its inception.[327] At the same time, some recent CCAA cases suggest that courts may have begun to apply CCAA protection in a more restricted manner than in the past, with the result that more CCAA proceedings will result in traditional

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[323] The Office of the Superintendent of Bankruptcy Canada (OSB) began recording all CCAA filings in September 2009. Its database is online: <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br02281.html>
[324] *Re Nortel Networks Corp* (2009), 56 CBR (5th) 224 (Ont Sup Ct).
[325] *Re Canwest Global Communications Corp*, 2009 CarswellOnt 7169 (Ont Sup Ct).
[326] *Re Indalex Limited*, 2011 ONCA 265.
[327] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003) at 16.

reorganizations rather than liquidations.[328] This will be discussed further below in Parts (iv) and (v).

(iii) Diverging Judicial Approaches

. Liquidating CCAAs are most commonly carried out in Ontario. Courts in Alberta and British Columbia – jurisdictions historically skeptical of such plans – have approved liquidating CCAAs only in exceptional circumstances.[329] In Alberta, the determination of appropriateness typically turns on the question of whether the debtor company will survive the proposed sale, as explained in *Royal Bank v Fracmaster*:[330]

> There must be an ongoing business entity that will survive the asset sale. . . A sale of all or substantially all the assets of a company to an entirely different entity, with no continued involvement by former creditors and shareholders, does not meet this requirement. . . Generally, such liquidations are inconsistent with the intent of the CCAA and should not be carried out under its protective umbrella.

In cases where the debtor company is not intended to survive the proposed liquidation, Alberta courts have terminated CCAA proceedings and ordered that the liquidation continue through a receivership.[331] Similarly, courts in British Columbia have expressed concern with the Ontario practice of approving liquidations under the CCAA where no restructuring plan is presented, the debtor's business operations will cease, and the end result will be a distribution of the proceeds to the creditors.[332]

The approaches to liquidating CCAAs by Ontario courts and those in Alberta and British Columbia appear irreconcilable. While some Western courts have acknowledged the appropriateness of Ontario liquidating CCAA decisions such as *Canadian Red*

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[328] For a discussion of this possible new trend, see Alan H Brown, "Liquidating Under the CCAA: An Overview of Recent Developments in *Cliffs Over Maple Bay* and *Pope & Talbot*" (2008) 17 Cred and Bank Lit 4.
[329] *Re 843504 Alberta Ltd* (2003), 4 CBR (5th) 306 (Alta QB) at paras 14-15.
[330] *Royal Bank v Fracmaster Ltd* (1999), 11 CBR (4th) 230 (Alta CA) at paras 15-16.
[331] *Ibid.*
[332] *Cliffs Over Maple Bay Investments Ltd v Fisgard Capital Corp*, 2008 BCCA 327 at para 32.

Cross[333] and *Bob-Lo Island*,[334] where the broader public interest was engaged, these Western cases are few and far between.[335] Additionally, *Red Cross* and *Bob-Lo Island* were cases in which the business operations of the debtor companies were sold on a going concern basis and remained operational. More generally, Western courts have expressed skepticism of CCAA proceedings in which the debtor company's only plan is to liquidate its assets piecemeal, wind up its business and distribute the proceeds to its creditors.[336]

An important question is whether a liquidating CCAA could serve the broader public interest by preserving jobs and existing relationships with consumers and suppliers of the debtor company. If so, there may be less reason to object to liquidating CCAAs, even if they do not fulfill the CCAA's purpose of keeping a company going despite insolvency. However, it is important to recall that jobs and business relationships are not the only factors that fall within the public interest. As discussed in Chapter 3, other factors may also be relevant. For example, the interests of pensioners may be relevant as well, particularly where the debtor manages a company pension plan. This issue will be discussed below in Part (v).

(iv) Resolving the Disagreement: *Century Services* and the Purpose of the CCAA

Shortly before section 36 came into force, one commentator stated:[337]

> Section 36 of the proposed amendments to the *CCAA* w illprovide courts across the country with the opportunity of re-assessing the approach to liquidating *CCAA*s. In that process, it is hoped that a broader examination of the divergent approaches in the various provinces will result in a more consistent and predictable approach to liquidating *CCAA*s

[333] *Re Canadian Red Cross Society* (1998), 5 CBR (4th) 299 (Ont CJ [Commercial List]).
[334] *Re 1078385 Ontario Ltd* (22 November 2004), (Ont Sup Ct); leave to appeal refused, [2004] OJ No 6050 (Ont CA).
[335] Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" [2008] Ann Rev of Insol L 33 at 52.
[336] *Cliffs Over Maple Bay Investments Ltd v Fisgard Capital Corp*, 2008 BCCA 327 at para 32.
[337] Bill Kaplan, "Liquidating CCAAs: Discretion Gone Awry?" [2008] Ann Rev of Insol L 79 at 130.

> across the country. The fact that each province shares a fundamentally consistent view of the policies and objectives of the statute, argues well for that process.

Although section 36 is still fairly new, a reassessment of liquidating CCAAs as suggested above now seems unlikely. The debate over liquidating CCAAs stems from irreconcilable interpretations of the Act. Alberta and British Columbia courts have said that they will approve liquidating CCAAs only in very exceptional circumstances. Meanwhile, courts in Ontario and Québec have continued to approve liquidating CCAAs since the 2009 amendments, with section 36 appearing to have no substantive effect on the judicial analysis of asset sale plans.[338]

While section 36 has proved unhelpful, some guidance on the liquidation vs. reorganization question may be found in the recent Supreme Court of Canada decision of *Century Services v Canada (Attorney General)*.[339]In *Century Services*, the Supreme Court directly interpreted the provisions of the CCAA for the first time. In its analysis, the Court identified the twofold purpose of the CCAA as follows:[340]

> [T]he purpose of the *CCAA* – Canada's first reorganization statute – is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets.

This is a clear statement that the CCAA is intended to facilitate the reorganization of insolvent companies so that they may continue on a going concern basis. Furthermore, in distinguishing between restructuring and liquidation, the Court stated that the liquidation of a debtor company's assets should occur only where restructuring has failed:[341]

> There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which

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[338] *Re Nortel Networks Corp* (2009), 56 CBR (5th) 224 (Ont Sup Ct); *Re Canwest Global Communications Corp*, 2009 CarswellOnt 7169 (Ont Sup Ct); *Re White Birch Paper Holding Co*, 2010 QCCS 4915 (Que Sup Ct).

[339] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60.

[340] *Ibid* at para 15.

[341] *Ibid* at para 14 (emphasis added). The question of what constitutes the "failure" of a restructuring process will be discussed further below in the analysis of *Indalex*.

> solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when thedebtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or itscreditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or toplace the debtor into receivership.

Taken together, these statements from the Supreme Court suggest that it is generally inappropriate to use the CCAA to effect a liquidation in which the insolvent company's business does not continue as a going concern. Although *Century Services* does not preclude liquidating CCAAs of this kind, the Court states that liquidations are a last resort and the least desirable outcome of a CCAA proceeding. In the above statement, the Court also says that the liquidation of a debtor company following a failed CCAA restructuring should follow the applicable provisions of the *Bankruptcy and Insolvency Act* (BIA).[342] This is further reason to question the appropriateness of liquidating CCAAs in general, since the CCAA contains no liquidation provisions similar to the BIA.

Despite *Century Services*, proponents of liquidating CCAAs may still argue that liquidating CCAAs are desirable where they avoid the negative consequences of liquidations under the BIA. For example, there are circumstances in which the sale of substantially all of the debtor company's assets on a going concern basis is achieved more efficiently under the CCAA than through a receivership. In these cases, insolvency administrators will avoid adopting certain liabilities of the debtor company – for environmental damage, for example – because they do not take control of the debtor company's assets as they would in a receivership.[343] Specifically, the Supreme Court of Canada decision in *TCT Logistics*[344]held that a receiver under the BIA could be a successor employer and that the courts should allow successorship questions to be

[342] *Bankruptcy and Insolvency Act*, RSC 1985, c B-3.
[343] Bill Kaplan, "Liquidating CCAAs: Discretion Gone Awry?" [2008] Ann Rev of Insol L 79 at 89.
[344] *GMAC Commercial Credit Corporation – Canada v TCT Logistics Inc,* 2006 SCC 35.

determined by labour relations boards. Given this ruling, insolvency administrators might favour the CCAA over a receivership in order to avoid successor employer liabilities. Proponents of liquidating CCAAs may argue that, as a practical matter, liquidating CCAAsare preferable to receiverships where the results are better for the stakeholders, either by maximizing returns for creditors, ensuring continuation of the debtor's business as a going concern, or both.[345] However, the fact that a liquidating CCAA may be more practical than a receivership does not mean that it is appropriate.[346]

The basic problem with liquidating CCAAs is twofold. Firstly, the CCAA is insolvency legislation, while liquidation is a bankruptcy process.The Supreme Court first recognized this important distinction in *Reference re Companies' Creditors Arrangement Act*:[347]

> Therefore, if the proceedings under this new Act of 1933 are not, strictly speaking, "bankruptcy" proceedings, because they had not for object the sale and division of the assets of the debtor, they may, however, be considered as "insolvency proceedings" with the object of preventing a declaration of bankruptcy and the sale of these assets, if the creditors directly interested for the time being reach the conclusion that an opportune arrangement to avoid such sale would better protect their interest, in whole or in part.

In *Century Services*, the Court again recognized the distinction between the bankruptcy and insolvency processes in Canadian law:[348]

> Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order by staying its creditors' enforcement actions and attempt to obtain a binding compromise. . . Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

Significantly, the Court went on to say that the liquidation and distribution scheme of the BIA "supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately

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[345] Shelley C Fitzpatrick, "Liquidating CCAAs – Are We Praying to False Gods?" [2008] Ann Rev of Insol L 33 at 52.
[346] *Ibid.*
[347] *Reference re Companies' Creditors Arrangement Act*, [1934] SCR 659 at para 17.
[348] *Ibid.*

unsuccessful."[349] This is another clear statement by the Supreme Court that liquidation under the CCAA should only occur after restructuring has failed, and then only according to the liquidation provisions of the BIA. This calls into question the appropriateness of liquidating CCAAs, approved by courts in Ontario and Québec, in which no plan is presented for the successful reorganization and continuation of the debtor company. Such plans cannot fall within the Court's meaning of restructuring as expressed in *Century Services*, since they do not contemplate any attempts to save the debtor company. Rather, they are liquidation plans, undertaken without reference to the liquidation and distribution processes of the BIA that should apply.

The second basic problem with liquidating CCAAs relates to the purpose of the Act. As discussed above, the CCAA is intended to facilitate the rehabilitation of the debtor company. Whatever the terms used – reorganization, rehabilitation, restructuring, or rescue – the goal of the CCAA is to facilitate the survival of the debtor company. In *Century Services*, the Supreme Court recognized that Parliament's original purpose in enacting the CCAA was to avoid liquidations where possible:[350]

> Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected – notably creditors and employees – and that a workout which allowed the company to survive was optimal.

This statement of the CCAA's purpose echoes earlier commentaries. During the first reading of the CCAA in Parliament in 1933, the Secretary of State C.H. Cahan stated that the Act was intended "to arrange for a settlement or compromise of the debts of the company in such a way as to permit the company effectively to continue its business by reorganization."[351] The CCAA was a response to the many corporate failures of the Great

[349] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at para 23.
[350] *Ibid* at para 17.
[351] *House of Commons Debates,* 17th Parl, 4th Sess, No 4 (1932-33) at 4090 (Hon CH Cahan).

Depression and was intended to prevent future failures and premature liquidations.[352] This purpose was reiterated in Stanley Edwards' seminal article "Reorganizations Under the Companies' Creditors Arrangement Act",[353] the only scholarly publication on the CCAA in the early decades following its enactment. In his article, Edwards stated that the object of the CCAA was "to keep a company going despite insolvency" and thus avoid the negative social and economic consequences of a premature liquidation.[354] In Edwards' view, this purpose made the CCAA an important part of Canada's bankruptcy and insolvency regime should another depression occur:[355]

> If there should be…a depression it will become particularly important that an adequate reorganization procedure should be in existence, so that the Canadian economy will not be permanently injured by discontinuance of its industries, so that whatever going concern value the insolvent companies have will not be lost though dismemberment and sale of their assets, so that their employees will not be thrown out of work, and so that large numbers of investors will not be deprived of their claims and their opportunity to share in the fruits of the future activities of corporations.

Similarly, in *Creditor Rights and the Public Interest*,[356] Janis Sarra explains that the CCAA was enacted to allow insolvent companies to avoid bankruptcy and liquidation where possible. The aim was to permit "workable and equitable" restructuring plans that had a reasonable chance of success:[357]

> An effective reorganization scheme would assist in preserving going-concern value of insolvent companies that had a good chance of survival, prevent the loss of many jobs, and help ensure that investors and creditors were not deprived of their claims or the opportunity to share in the value of future activities of the company.

In Sarra's view, this purpose reflected Parliament's intention that courts in CCAA proceedings should consider the broader interests at stake in cases of corporate failure. These interests included those of consumers, investors, employees and the public

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[352] *Ibid.*
[353] Stanley E Edwards, (1947) 25 Can Bar Rev 587.
[354] *Ibid* at 592.
[355] *Ibid* at 590.
[356] Janis Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (Toronto: University of Toronto Press, 2003).
[357] *Ibid* at 14.

generally.[358]

When the CCAA came into use again in the 1980s, early decisions again pointed to the Act's underlying purpose of preserving the debtor company. In 1984, the Alberta Court of Queen's Bench released *Meridian v. T.D. Bank,*[359] in which it stated:

> The legislation is intended to have wide scope and allows a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors.

This interpretation was reiterated in *Oakwood Petroleums*[360] in 1988 and has been cited frequently in CCAA decisions since.[361]

(v) The *Indalex* Decision

Indalex[362] involved a claim under the Ontario *Pensions Benefits Act* (PBA)[363] by pensioners of a debtor company that had sold its assets in a liquidating CCAA. Indalex filed for protection under the CCAA in the Ontario Superior Court, obtained debtor-in-possession (DIP) financing and began the process of selling its assets on a going concern basis. In exchange for their loans, the DIP lenders received a guarantee and a super-priority charge over the proceeds of the going concern sale.[364] However, the proceeds of this sale were insufficient to satisfy both the DIP lenders' claim and the claim of pensioners under the company-administered plan. The pensioners pointed to section 57 of the PBA, which created a statutory deemed trust in their favour, and argued that the trust had priority over the DIP lenders' charge. The CCAA judge disagreed and held that

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[358] *Ibid* at 15.
[359] *Meridian Developments Inc v Toronto-Dominion Bank* (1984) 52 CBR (NS) 109 (Alta QB).
[360] *Norcen Energy Resources Ltd v Oakwood Petroleums Ltd* (1988), 72 CBR (NS) 1 (Alta QB) at para 61.
[361] See, for example, *Re United Used Auto & Truck Parts Ltd* (2000), 16 CBR (4th) 141 (BCCA) at paras 10-12.
[362] *Re Indalex Limited*, 2011 ONCA 265.
[363] *Pensions Benefits Act*, RSO 1990, c P8.
[364] *Ibid* at para 53.

the DIP lenders' claim had priority over the pensioners.

The Court of Appeal overturned the lower court's decision and gave effect to the deemed trust over the super-priority charge.[365] The Court further held that Indalex had breached its fiduciary duties as administrator of the pension plan, and that this gave rise to a constructive trust over the proceeds of the asset sale. Therefore, in the event that the statutory deemed trust did not have priority over the DIP lenders' charge, a constructive trust would apply so as to satisfy the pensioners' claim.[366]

Indalex is significant on the issue of liquidating CCAAs for at least two reasons. Firstly, the Court of Appeal clearly distinguished between a liquidating CCAA and a restructuring. This was a point of contention between the parties in the Superior Court proceedings. Counsel for the pensioners brought a motion arguing that since the Indalex plan was a liquidating CCAA and not a restructuring, it was inappropriate to use the CCAA to stay the pensioners' benefits claims against Indalex.[367] In his decision rejecting the pensioners' motion, Morawetz J. stated:[368]

> I fail to see the relevance of this submission. At the present time, the Applicants are properly under CCAA protection. No motion has been brought to challenge the appropriateness of CCAA proceedings and, in my view, nothing in the CCAA precludes the ability of a debtor applicant to sell its assets.

Morawetz J. went on to distinguish the British Columbia case of *Doman Industries*,[369] in which Tysoe J., as he then was, held that it is insufficient for a CCAA court to authorize the termination of a debtor company's contracts merely on the basis that doing so will reduce the debtor's costs.[370] Counsel for the pensioners had relied on *Doman* in arguing

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[365] *Re Indalex Limited*, 2011 ONCA 265 at para 207.
[366] *Ibid* at para 197.
[367] *Re Indalex Limited* (2009), 55 CBR (5th) 64 at para 14.
[368] *Re Indalex Limited* (2009), 55 CBR (5th) 64 at para 15.
[369] *Re Doman Industries Ltd*, 2004 BCSC 733.
[370] *Re Indalex Limited* (2009), 55 CBR (5th) 64 at para 17.

that Indalex should not be allowed to forego its payments to pensioners simply because this would reduce costs. Morawetz J. distinguished *Doman* on the basis that it concerned statutory "replaceable contracts" in which the debtor company would have to offer a new contract on expiry of the old as long as the other contracting party was not in default, a contractual situation which he considered much different from that between Indalex and its pensioners.

While the reasons for decision on the pensioners' motion do not elaborate on the issue of liquidating CCAAs, counsel for Indalex argued in its motion factum that the sale of substantially all of Indalex's assets on a going concern basis should not be characterized as a liquidating CCAA. According to this argument, the Indalex plan was a restructuring because it resulted in the continuation of Indalex's business. In its factum, counsel for Indalex submitted:[371]

> Contrary to the assertions of the Retired Executives, this is not a "liquidating CCAA", this is a complex cross-border restructuring involving the going concern sale of the assets of the Applicants. . . The anticipated result of these proceedings is a successful going concern solution and accordingly, these proceedings are anything but a "liquidating CCAA".

The Court of Appeal disagreed:[372]

> Recall that this was a "liquidating CCAA" from the outset. There was no restructuring of the company. There was no plan of compromise or arrangement prepared and presented to creditors. Within days of obtaining *CCAA* protection, Indalex began a marketing process to sell itself. Very shortly thereafter, it sold its business as a going-concern.

In the Court of Appeal's view, the purpose of the CCAA was "to facilitate the restructuring of failing businesses to avoid bankruptcy and liquidation."[373] Although it distinguished between the Indalex liquidating CCAA and a restructuring, the Court of

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[371] *In the Matter of a Plan of Compromise or Arrangement of Indalex Limited, Indalex Holdings (B.C) Ltd., 6326765 Canada Inc. and Novar Inc*, Ontario Superior Court of Justice (Commercial List), Factum of the Applicants, July 1, 2009 at para 16. Online: <http://cfcanada.fticonsulting.com/indalex/docs/Factum.pdf>.
[372] *Re Indalex Limited*, 2011 ONCA 265 at para 180.
[373] *Ibid* at para 180.

Appeal apparently saw the Indalex sale process as appropriate because it preserved value for suppliers and customers as well as approximately 950 jobs for former employees.[374] However, in a surprising decision, the Court of Appeal also held that granting the pensioners' deemed trust priority over the DIP lenders' charge would not have frustrated the plan, since Indalex merely intended to sell itself. Consequently, while the Court of Appeal did not object to the liquidating CCAA as such, it nonetheless removed an incentive for debtors to pursue similar sales in the future, stating: "[t]he CCAA was not designed to allow a company to avoid its pension obligations."[375]

It is also notable that the Indalex plan provided for the survival of the underlying business and the preservation of jobs. This is the least objectionable type of liquidating CCAA because it avoids the negative social and economic consequences of bankruptcy such as the loss of jobs. However, given the Court of Appeal's statement that the CCAA is intended to avoid bankruptcy and liquidation, it seems unlikely that the Court would have approved of the Indalex plan if the plan had contemplated merely a piecemeal liquidation with no continuing business.[376]In sum, without explicitly questioning the appropriateness of liquidating CCAAs, *Indalex* may have a chilling effect on such sales in the future. As Janis Sarra noted in a 2006 study, unfunded pension liabilities "have been the driver of a significant number of recent *CCAA* filings."[377] By favoring pensioners over DIP lenders in a CCAA proceeding, the Court of Appeal in *Indalex* may discourage future filings.

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[374] *Re Indalex Limited*, 2011 ONCA 265 at para 182.
[375] *Ibid* at para 199.
[376] *Ibid* at para 180.
[377] Janis Sarra, "Development of a Model to Track Filings and Collect Data for Proceedings Under the *CCAA*", Final Report to the Office of the Superintendent of Bankruptcy Canada (March 2006), online: <http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01669.html>

<u>(vi) The Future of Liquidating CCAAs Post-*Indalex*</u>

The Court of Appeal's reasoning in *Indalex* rejects the notion that a going concern sale of substantially all of a debtor company's assets is functionally equivalent to a restructuring in which the debtor company survives.[378] The Court of Appeal stated that the Indalex plan was a liquidating CCAA and not a restructuring because no plan was prepared and presented to creditors and Indalex merely intended to sell itself.[379] As discussed in part (ii) of this chapter, the better view is that the term "liquidating CCAA" covers a range of possible transactions that may include both going concern sales and sales in which the business operations of the debtor cease. The fact that some types of liquidating CCAAs involve going concern sales that result in the continuation of a debtor's business does not make them the same as a restructuring.

In identifying the Indalex sale process as a liquidating CCAA, the Ontario Court of Appeal may have brought itself one step closer to the Alberta and British Columbia Courts of Appeal on this issue. Specifically, those courts have distinguished between liquidating CCAAs and an actual restructuring, in which a plan is presented to the creditors. However, Western courts have taken the additional step of questioning whether liquidating CCAAs are appropriate at all, encouraging the sales through receivership or bankruptcy instead.[380] There was no discussion of this possibility in the *Indalex* decision, and it seems that the Ontario and Western courts part company on this point. Still, by identifying the Indalex sale process as a liquidating CCAA, the Ontario

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[378] As mentioned earlier, counsel for Indalex advanced this argument at trial. For a recent commentary also advancing this argument, see Karma Dolkar, "Re-Thinking "Rescue": A Critical Examination of CCAA Liquidating Plans" (2010), forthcoming in *Banking and Finance Law Review* (2011). Online: <http://www.insolvency.ca/docs/writingAwards/file20101111060008163.pdf>.
[379] *Re Indalex Limited*, 2011 ONCA 265 at para 180.
[380] *Cliffs Over Maple Bay Investments Ltd v Fisgard Capital Corp*, 2008 BCCA 327 at para 32; *Royal Bank v Fracmaster Ltd* (1999), 11 CBR (4th) 230 (Alta CA) at paras 15-16.

Court of Appeal may have opened the door to further discussion of this issue in the future.

An important problem with the *Indalex* decision is that the Court of Appeal seemed to view the Indalex liquidating CCAA as a success because it resulted in the going concern sale and continuation of the debtor's business "albeit through another entity."[381] This raises two related issues.

The first issue is how to define "liquidating CCAA." The Ontario Court of Appeal in *Indalex* emphasized that the CCAA was intended to avoid bankruptcy and liquidation, but saw no problem with characterizing the Indalex liquidating CCAA as a success.[382] The Court of Appeal explained that the Indalex liquidating CCAA was different from a piecemeal liquidation because it resulted in the continuation of the debtor's business. On this basis, the Court of Appeal distinguished *Century Services* because that case involved a failed restructuring in which "liquidation on a piecemeal basis through bankruptcy was inevitable."[383] This is a questionable distinction because *Century Services* explains what should happen in CCAA proceedings in both successful and unsuccessful cases. In *Century Services*, the Supreme Court specifically said that the continuation of the debtor's business as a going concern is the ideal result of CCAA proceedings, whereas liquidation – under either the BIA or through a receivership – typically occurs only after a failed restructuring.[384] While this statement by the Supreme Court does not preclude liquidating CCAAs, the fact that they are not mentioned as one of the ways to exit CCAA proceedings speaks against their widespread use and against

[381] *Re Indalex Limited*, 2011 ONCA 265 at para 188.
[382] *Ibid* at para 188.
[383] *Ibid.*
[384] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at para 14.

the suggestion in *Indalex* that a form of liquidation can be termed "successful" in the context of the CCAA, which is a restructuring statute. Furthermore, although it is true in the case of the Indalex sale process, the Court of Appeal's suggestion that a liquidating CCAA is different from piecemeal liquidation is not true in all cases. The problem lies with the ambiguity of the term "liquidating CCAA", which has been used to refer both to going concern sales and piecemeal liquidations. Until Parliament or the Supreme Court of Canada clarifies the meaning of this term, it would be preferable if counsel and the courts specified what kind of liquidating CCAAs they mean to discuss, referring to the spectrum of scenarios discussed in Part (ii). That is, a liquidating CCAA might refer to the sale of substantially all of the debtor company's assets to: (a) a single buyer who intends to continue the business operations of the debtor company; (b) many buyers who intend to continue different parts of the business operations, or (c) many buyers who have no intention of continuing the business operations of the debtor company.

The second issue is how to define success in CCAA proceedings. The Court of Appeal viewed the Indalex liquidating CCAA as a success because it enhanced value for employees, customers and suppliers by keeping the business going.[385] As a preliminary point, "success" in the restructuring context is often a murky concept. A company might emerge from CCAA protection only to fail six months or a year later. On the other hand, a company might prosper for reasons that have nothing to do with its restructuring plan. In a recent article for the *Annual Review of Insolvency Law*, Blair J.A. of the Ontario Court of Appeal summarized the problem as follows:[386]

> Moreover, what does "success" mean? Is it enough to say "implementation of the court-

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[385] *Re Indalex Limited*, 2011 ONCA 265 at para 188.
[386] Robert Blair, "The *CCAA* Over 30 Years: From Chrysalis to Butterfly or Chrysalis to Gadfly? Some Thoughts From an Appellate Perspective" [2010] Ann Rev of Insol L 557 at 566.

> approved plan"? What about pre-packaged asset sales or other cases where there may be a satisfactory resolution, but no plan approval. . . Does there have to be some broader "public interest" dimension, like the continuation of the business in its present or a different form? I don't know. I'm just asking.

The Supreme Court may have provided an answer to these questions in *Century Services.* As discussed in Part (iv) of this chapter, the Court in *Century Services* suggested that liquidation should normally occur only when restructuring has failed. Specifically, the Court stated that the most desirable outcome of a CCAA proceeding is that the debtor company survives and emerges from insolvency.[387] If this outcome is the basic measure of success, then a liquidating CCAA cannot be an unqualified success because it involves the demise of the debtor company. Nonetheless, Ontario courts have focused on the survival of the underlying business rather than the debtor company. This approach favours going concern sales because they can preserve jobs and existing relationships with customers and suppliers. However, this approach may ignore the fact that there are other public interests at stake in CCAA proceedings, such as the preservation of pensions. The Ontario Court of Appeal in *Indalex* got around this problem by focusing on the fiduciary duties that the company owed to its pensioners, giving priority to the pensioners over the DIP lenders. However, this approach required a questionable distinction about why *Century Services* did not apply to the Indalex situation. For these reasons, and the fact that the CCAA is primarily a reorganization statute designed to keep the debtor company going despite insolvency, liquidating CCAAs should be viewed with skepticism.

Indalex may discourage some future liquidating CCAAs in Ontario because debtor companies and potential purchasers in CCAA sales will no longer enjoy the same

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[387] *Century Services Inc v Canada (Attorney General)*, 2010 SCC 60 at para 14.

protection from the enforcement of obligations to pensioners.[388] Arguably, a debtor company or its secured creditors could find ways around this problem by filing an application for a bankruptcy order before entering CCAA protection, forcing beneficiaries of the debtor company's pension plan to negotiate at the risk of losing their claims entirely should the company become bankrupt.[389] However, there is a word of caution here from both the trial and appellate decisions in *Indalex*. At trial, Campbell J. stated:[390]

> In my view, a voluntary assignment under the *BIA* should not be used to defeat a secured claim under valid Provincial legislation, unless the Provincial legislation is in direct conflict with the provisions of Federal Insolvency Legislation such as the *CCAA* or the *BIA*. For that reason I did not entertain the bankruptcy assignment motion first.

The Court of Appeal reiterated this view in its decision:[391]

> As for the suggestion that Indalex will pursue its bankruptcy motion in order to defeat the deemed trust, I would simply echo the comments of the *CCAA* judge that a voluntary assignment into bankruptcy should not be used to defeat a secured claim under valid provincial legislation. I would add this additional consideration: it is inappropriate for a *CCAA* applicant with a fiduciary duty to pension plan beneficiaries to seek to avoid those obligations to the benefit of a related party by invoking bankruptcy proceedings when no other creditor seeks to do so.

Given the above statements, debtor companies seeking to take advantage of the BIA's reversal of some priority claims – in effect using the threat of bankruptcy to gain leverage in negotiations with claimants like pensioners – may be seriously limited. Where the debtor is also the administrator of its employees' pension plans, courts will expect it to act in a manner consistent with its fiduciary obligations to pensioners. Presumably, in

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[388] It is beyond the scope of this paper to discuss the issues of priorities and paramountcy that arise here in light of the Supreme Court's decision in *Century Services*, which Gillese J.A. discussed at length in *Indalex*. The point in mentioning this is simply that debtor companies, as well as lenders, may no longer enjoy guaranteed protection against such claims in Ontario. As this was an incentive for applying for CCAA protection in the past, *Indalex* may deter future applications, particularly those contemplating a plan that might be characterized as a liquidating CCAA.

[389] At least one Toronto restructuring lawyer has suggested that this is more or less what will happen if *Indalex* is not reversed or narrowed on appeal.

[390] *Re Indalex Limited*, 2010 ONSC 1114 at para 55.

[391] *Re Indalex Limited*, 2011 ONCA 265 at para 183.

such cases, it would fall to other secured creditors of the debtor company to negotiate directly with the pensioners in order to achieve a workable restructuring plan. This would be a desirable outcome because of the public interest purpose of the CCAA, as discussed here and in Chapter III. The Canadian restructuring regime is not merely a tool to facilitate the maximization of returns for creditors. Ideally, as the Supreme Court stated in *Century Services*, CCAA proceedings will lead to the continuation of the debtor company as a going concern to the benefit of all stakeholders. Even where the debtor company does not survive, *Indalex* is a reminder that other stakeholders besides secured creditors may have significant interests in the outcome of CCAA proceedings – interests that the court should recognize and balance with those of the secured creditors.

(vii) Conclusion

Liquidating CCAAs should be viewed with skepticism, especially where there is no intention to continue the debtor company's business. This is because the CCAA is primarily a statute for reorganizing insolvent companies rather than liquidating them. Chapter IV explained why the addition of section 36 of the Act merely answers the question of whether CCAA courts have the jurisdictional authority to approve asset sales – it does not solve the problem of liquidating CCAAs because it does not provide specific criteria for determining when a liquidating CCAA will be appropriate.

The fundamental question is under what circumstances a liquidating CCAA is appropriate. Some commentators, such as Baird and Rasmussen, have argued that courts should focus on maximizing sale value. However, in Canada, the CCAA was not originally intended as a liquidation statute. The recent Supreme Court of Canada decision *Century Services* suggests that the sale of assets, whether piecemeal or on a

going concern basis, and the winding up of the debtor's business is best accomplished typically through bankruptcy or receivership rather than the CCAA. Nonetheless, some courts will continue to see liquidation, particularly going concern sales, as an attractive option in CCAA proceedings.

In Ontario, the focus of the court's analysis remains the survival of the underlying business rather than the debtor company itself. This approach favours liquidating CCAAs where they can preserve jobs and value for consumers and suppliers through a going concern sale of the debtor's business. In such cases, it is important to recall the public interest purpose of the CCAA that the Supreme Court of Canada emphasized in *Century Services*. Jobs, customers and suppliers are not the only factors that are captured by the "public interest." In *Indalex*, the Ontario Court of Appeal approved of a liquidating CCAA in which the debtor company's underlying business was saved, but refused to allow the company to pay its DIP lenders before its pensioners. Although the Court of Appeal focused on the fiduciary obligations of the debtor to its pensioners rather than on pensions as a public interest factor under the CCAA, this decision is a reminder that pensions are an important consideration in CCAA proceedings. In the future, a more robust public interest analysis that takes into account pensions, in addition to jobs and suppliers, would be desirable because it would allow the CCAA court to engage in a fair balancing of these interests without inviting controversies over paramountcy or the interaction of the CCAA with other areas of law such as fiduciary obligations. Furthermore, this might avoid future appeals where groups of stakeholders, such as pensioners, claim that their interests have been ignored in the CCAA process. Hopefully, this will lead to a more restrained approach toward liquidating CCAAs in Ontario and

Québec in the future, as courts in these provinces ask in broader terms, and perhaps more skeptically, whether the public interest is being served. Should this come to pass, it would be a welcome change both with respect to the underlying purposes of the CCAA and the development of a more consistent, predictable approach to the CCAA in courts across Canada.

CONCLUSION

This thesis has examined the problem of CCAA liquidations in light of the CCAA's history, purpose and place in Canada's bankruptcy and insolvency system. This thesis began by asking two questions:

1) **Are liquidations appropriate under the CCAA?**

2) **If so, under what circumstances?**

This thesis has argued that CCAA liquidations should be approached with caution because generally they are not consistent with the purposes of the statute. However, where restructuring has failed, or where all stakeholders are better served – including those captured by the broad concept of the "public interest" – liquidation under the CCAA may be appropriate. The key to this analysis is defining the types of liquidations contemplated and the likely effects on the broad constituency of stakeholders in a restructuring.

Chapter I began by suggesting that the CCAA historically was intended as a statute for restructuring companies so that they could avoid liquidation. Chapter II examined several leading decisions on the CCAA in light of the historical purposes of the statute. Based on this discussion, Chapter III considered competing theories of restructuring in order to develop a robust account of the CCAA's purpose and place in Canada's bankruptcy and insolvency system, giving particular attention to the "public interest" purpose of the statute and the debate over liquidations. Chapter IV explained why the 2009 amendments have not answered the fundamental questions raised by CCAA liquidations. Finally, Chapter V analyzed the liquidation vs. reorganization debate in detail. Chapter V suggested that CCAA liquidations should be approached with caution, both because the statute was designed to facilitate reorganization rather than

liquidation and because the "public interest" purpose of the CCAA often is engaged in liquidation scenarios.

Chapter V also suggested that a more robust concept of the public interest, applied rigorously by the courts, could help to avoid the sorts of problems faced in recent decisions such as *Indalex*,[392] in which the Court of Appeal for Ontario applied fiduciary law to alter the priority of creditors in a CCAA proceeding as established by the lower court. Even if the result in *Indalex* was desirable, the decision has created greater uncertainty for participants in restructuring proceedings because the various outcomes of the CCAA's interaction with other areas of the law, including the common law on fiduciary obligations, are unclear. This situation can be remedied by adopting a more robust "public interest" analysis in CCAA proceedings that would address the concerns, raised in cases such as *Indalex*, that some stakeholders are treated unfairly in the restructuring process. For example, as discussed in Chapter V, a broader concept of the public interest, which would include the interests of pensioners of the debtor company, could be considered and balanced with the interests of traditionally recognized groups such as lenders. Such an approach – whether it is developed in the courts or codified through amendments to the CCAA – would lead both to greater certainty and greater consistency in CCAA proceedings in the different provinces.

At least three changes to the current restructuring regime could provide greater clarity and certainty with respect to CCAA liquidations.Thus far, courts have not engaged in an analysis of the public interest in CCAA proceedings as a matter of course. This thesis argues that courts should always engage in such an analysis, especially when

[392] *Re Indalex Limited*, 2011 ONCA 265.

public interest stakeholders must bear the consequences of CCAA proceedings.Far from muddying the waters, such an approach offers greater clarity than the current one, in which issues of environmental damage or pension liabilities of insolvent companies are not considered in lower courts' analyses and are left for consideration only in appellate decisions.[393] This has led to great surprise and uncertainty in cases, like *Indalex*, where an appellate court has decided that the CCAA does not necessarily allow a court to ignore the claims of pensioners.

Secondly, a more robust analysis of what is meant by the public interest is necessary. The term "public interest" is often used but rarely defined in either the case law or the literature. If either the Supreme Court of Canada or Parliament were to provide a definition, such as a non-exhaustive list of factors that fall under the public interest analysis, all participants in the CCAA process would have a better idea of what to expect.

Finally, it is crucial to distinguish between the different types of liquidations that might occur under the CCAA because some types of liquidations are more objectionable than others. The term "liquidating CCAA" might refer to the sale of substantially all of the debtor company's assets to: (a) a single buyer who intends to continue the business operations of the debtor company; (b) many buyers who intend to continue different parts of the business operations, or (c) many buyers who have no intention of continuing the business operations of the debtor company. Where a liquidation actually serves the purposes of the CCAA by avoiding the negative social and economic consequences that otherwise would befall the stakeholders of the insolvent company, then a liquidation will

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[393] The *Abitibi* and *Indalex* cases are good examples of how the CCAA court's inability or unwillingness to address the interaction of the CCAA with environmental or pension liabilities of the insolvent company has led to appeals to the Supreme Court of Canada.

be appropriate. It is implicit in this approach that the "stakeholders" are broadly defined, since the public interest is a broad concept that refers to many different interest groups and factors.

It is hoped that these changes will facilitate a reasoned, cautious approach to liquidating CCAAs in which the interests of all those affected by a liquidation are considered and all stakeholders are encouraged to participate in the process. This approach reflects the Supreme Court of Canada's statement in *Century Services* that "the chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit."[394]

[394] *Century Services v Canada (Attorney General)*, 2010 SCC 60 at para 17.

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