

EQUIFAX CANADA
NATIONAL INSOLVENCY GROUP

Submissions to the Senate of Canada
Banking, Trade and Commerce Committee

Issues in the Reform of Canadian
Insolvency Legislation

Presented by E. Bruce Leonard and
David S. Ward, Cassels Brock & Blackwell,
Toronto and by Melvin C. Zwaig,
Zwaig Consulting Inc., Toronto

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About Equifax Canada

Equifax Canada Inc. (“Equifax”) is a leader in the Canadian consumer and commercial credit reporting and information services industry. Founded in 1919, Equifax delivers sophisticated decision making, data, fraud and e-commerce solutions to the business community which in turn, allows Canadians to safely and conveniently participate in millions of financial transactions daily.

Equifax is comprised of a national network of affiliated offices and employs over six hundred associates. Equifax’s Canadian members include over 6,000 banks, retailers, wholesalers, manufacturers, government agencies, insurance companies, public utilities and diversified financial services organizations. Equifax responds to between 4.5 and 5.0 million commercial credit requests every year.

Equifax’s National Insolvency Group was established five years ago to address bankruptcy and insolvency policy issues of concern to Equifax customers across the country. The National Insolvency Group meets regularly to discuss areas of general concern relating to insolvency reform in Canada.

Authors' Qualifications and Background

E. Bruce Leonard, B.A., LL.B., F.I.I.C.

Mr. Leonard is the Chair and a Director of the International Insolvency Institute and is the partner-in-charge of the Business Reorganization Group at Cassels Brock & Blackwell LLP in Toronto, was admitted to practice in 1970 and has practiced insolvency for almost all of his entire career.

Mr. Leonard is Past Chair of the International Bar Association's Committee on Insolvency and Creditors' Rights (comprising 1200 lawyers from over 80 countries). He is a Founding Member of and served as the Chair and a Director of The Insolvency Institute of Canada, a limited membership invitational organization of senior insolvency professionals in Canada, from its inception in 1990 to 2002. Mr. Leonard is the Chair, a Director and a Founding Member of the International Insolvency Institute, a limited membership global organization of senior insolvency professionals.

Mr. Leonard is a Member of the American Law Institute where he served as Chair and Co-Reporter for Canada on the American Law Institute's *Transnational Insolvency Project*. He served as the Co-Chair of the Government of Canada's Bankruptcy and Insolvency Committee Working Group on International Insolvencies and is a Member of the Ontario Court of Justice Chief Justice's Committee on Commercial Law Proceedings. Mr. Leonard is a Past Director of the American Bankruptcy Institute and Co-Chair of the ABI's International Committee (1997-2000). He was elected as the only international Conferee of the United States National Bankruptcy Conference and is a Fellow of the American College of Bankruptcy and a Fellow of the American Bar Foundation. Mr. Leonard served as Co-Director of the LL.M. Program in Insolvency Law at the Osgoode Hall Law School

of York University, Canada's only graduate program in insolvency.

Mr. Leonard has been elected to the *Guide to the World's Leading Insolvency and Restructuring Lawyers* since the inception of the *Guide* in 1987. He has also been named to *Canada's Top 500 Lawyers (Lexpert/American Lawyer)* in its first five years of publication from 1999 to 2003. He is the Past Chair of the Insolvency Law Section of the Ontario Bar Association and served as Vice-Chair of the International Bankruptcy Subcommittee of the American Bar Association's Business Bankruptcy Committee.

Mr. Leonard is the Co-Author of *Current Developments in International Insolvencies and Reorganizations* (Graham and Trotman: London, 1994), Co-Editor of *Multinational Commercial Insolvency* (American Bar Association: Chicago, 1993), and the author of *Guide to Commercial Insolvency in Canada* (Butterworths, 1988). Mr. Leonard is a Contributing Editor of *Norton Bankruptcy Law and Practice*, a Contributing Editor of *Collier's International Business Insolvency Guide*, a Contributing Editor to the American Bankruptcy Institute *Journal* and a member of the Editorial Board of *Tolley's Insolvency Law and Practice* (London). Mr. Leonard has participated in many of the most significant reorganizational proceedings in Canada and internationally including Olympia & York, Confederation Life Insurance, Johns Manville, Cadillac-Fairview, Dome Petroleum, Massey-Ferguson, Bramalea Inc., Everfresh Beverages, Dow Corning, Eaton's of Canada, Philip Services, Loewen Group, Standard Trustco, Canadian Airlines, 360 Networks, Owens Corning, AT&T Canada, GT Group Telecom, Teleglobe Inc., and Air Canada, among others.

Melvin C. Zwaig, F.C.A., C.A.-C.I.R.P., C.F.E.

Mel Zwaig is the founder of Zwaig Consulting Inc. and has a 40-year record of providing counsel on corporate restructurings and monitorings as well as forensic auditing; investigative accounting; corporate finance; litigation consulting and statutory insolvency services. His experience spans several industries such as retail, airlines, financial services, and not-for-profit.

Mr. Zwaig is a member of the Canadian Association of Insolvency and Restructuring Professionals; a member of the Canadian, Quebec, Ontario and Alberta Institutes of Chartered Accountants; a Founding Member of the Insolvency Institute of Canada; a Founding Member of the International Insolvency Institute; and an Associate International Member of the Institute of Certified Public Accountants of Israel.

He has advised Canadian federal and provincial governments on matters related to insolvency, including the Senate Committee of Banking Trade and Commerce, Minister of Consumer and Corporate Affairs (federal), Ministry of Health (federal), Canada Mortgage Housing Corporation, Competition Bureau of Canada; Government of Poland; Government of Quebec; and Attorney General, Ontario.

Recently, he was retained by the Office of the Attorney General of Trinidad and Tobago to advise them on drafting their insolvency legislation. He is also an advisor to Equifax Canada on insolvency matters.

Mr. Zwaig is a Certified Fraud Examiner and a member of the Institute of Arbitration and Mediation. He has recently been appointed International Director of the Turnaround Management Association and an International Fellow of the American College of Bankruptcy.

Mr. Zwaig is presently Executive in Residence, Schulich School of Business, York University; a Senior Advisor to Hill and Knowlton, Canada, and Strategic Surveys International, New York.

Mel is co-author of *The Proposed Bankruptcy Act, 1975 (Bill C-60)*; and *The Proposed Bankruptcy Act, 1978 (Bill S-11)*. Both were published by Richard de Boo Limited. Mel has also authored many articles and papers which have been presented and published during his career.

Mr. Zwaig has been involved in the administration of the some of the largest files in Canada, including: Abacus Cities Ltd.; Air Canada ; All Canada Express; Bank of Credit and Commerce Canada; Canadian Javalin; Canadian Red Cross; Christian Brothers of Ireland; Dome Petroleum, Bramalea; Eatons of Canada; GT Group Telecom; Seabrook Farms Frozen Foods Ltd.; Shoppers Trust; and Standard Rollins, among others.

David S. Ward, B.A., J.D., LL.M.

David Ward is a partner in the Business Reorganization Group at Cassels Brock & Blackwell, LLP. He has a litigation emphasis to his insolvency practice, with a particular focus on creditors' rights and restructuring under both the Canadian Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act. Most recently, David acted as counsel in the cross-border reorganization that involved the first application between Canada and the United States of the International Bar Association's Cross-Border Insolvency Concordat, a leading initiative in international insolvency co-operation.

Mr Ward is an active member of the Canadian Bar Association, the American Bar Association, and the International Bar Association. A graduate from the University of Toronto Law School, David was admitted to the bar in 1992. David attended the University of Western Ontario and recently completed an LLM in Insolvency Law at Osgoode Hall Law School, Canada's first postgraduate program in Insolvency Law.

Issues in the Reform of Canada

Insolvency Legislation

1. Introduction: Insolvency Reform Issues Relating to Suppliers of Goods and Services.

Equifax has been involved in Canadian insolvency and credit issues for decades. Equifax established its National Insolvency Group to identify issues in Canada's current bankruptcy system which are unfair to unsecured creditors generally and to suppliers of goods and services in particular and to formulate submissions for presentation to the Government of Canada for recommended changes to Canada's insolvency legislation.

With a view to constructively contributing to the insolvency reform process, Equifax commissioned a survey of its members on a broad range of issues concerning the treatment of suppliers in proceedings under the *Bankruptcy and Insolvency Act* ("BIA") and the *Companies' Creditors Arrangement Act* ("CCAA"). The survey results were analyzed and the reform issues they gave rise to were developed and debated over several years of meetings of the Equifax National Insolvency Group.

The clear consensus from these deliberations is that there are insufficient statutory protections for unsecured suppliers of goods and services in the current insolvency regime. The protections that do exist are frequently of uncertain or impractical application. The balancing and safeguard provisions, which similarly-positioned creditors enjoy in the United States and other countries, are missing altogether in Canada.

In the result, many Equifax members feel that they have few if any substantive rights in a bankruptcy or restructuring proceeding. They believe that only the largest and most well-funded stakeholders can access information and take steps to enhance their recovery. Believing that there is little if anything they can do to protect their positions in an insolvency, trade creditors have grown cynical of the process.

These submissions focus on several insolvency reform issues that were repeatedly identified as major areas of concern that are deserving of special attention in the current round of BIA and CCAA reform. These issues are: (a) 30 Day Goods Provisions; (b) Creditors' Committees; (c) Monitors in CCAA Reorganizations; (d) Independence and Accountability of Insolvency Representatives; (e) Reorganization Period Credit; and (f) Information Availability to Creditors in Insolvencies.

2. *30 Day Goods Provisions*

The 1992 amendments to the BIA (but not the CCAA) introduced provisions which were intended to safeguard the rights of unpaid suppliers by providing them with the right to recover unpaid goods that they had sold to an insolvent buyer. These rights became known as "30-day goods rights".

The Canadian 30-day goods rights, however, have not provided satisfactory protections to unpaid suppliers to insolvent businesses. Experience has shown that a reorganizing business can invariably stave off the statutory claims of unpaid suppliers until the goods in question have been consumed in the manufacturing process or have otherwise become unavailable for recovery under the restrictive terms of the BIA.

Under the current system, goods shipped by unpaid suppliers may be recovered under the BIA if they were supplied to a purchaser who became bankrupt or was placed in receivership provided that, among other things, a proper demand for their return is made within thirty days of the delivery of the goods. To be recovered, the goods must be in the possession of the purchaser or its trustee or receiver; they must be identifiable as *the* goods delivered by the supplier; they must be in the same state as they were on delivery and they must not have been resold to an arm's length purchaser.

While attractive in theory, there are numerous practical impediments to enforcing unpaid suppliers' 30-day goods rights in reorganizations. First and foremost, the rights of unpaid suppliers to repossess goods are stayed under the stays of proceedings that are

imposed in both BIA and CCAA reorganizations so that these rights are usually extinguished in reorganizations. The difficulty is that a filing under the CCAA, while it is clearly an insolvency filing, does not create 30 day goods rights since a receiver or trustee is almost never appointed in an initial CCAA Order. By the time that a receiver or trustee is ultimately appointed (which is the triggering event for 30 day goods rights) if the reorganization fails, the 30 day period will have expired which thereby eliminates the unpaid supplier's rights. For instance, if a reorganizational proceeding takes four months before it fails and a receiver is appointed, the unpaid suppliers' goods on hand at the outset will likely have been commingled with similar goods, or consumed in the manufacturing process during the reorganizational period. In each case, the reorganizing business obtains the benefit of the goods that have been delivered to it but there is no corresponding obligation to pay for those goods and, in each case, the unpaid suppliers are left with no remedies and no recovery for the goods they have supplied immediately prior to the filing for protection.

A further difficulty with the 30 day goods provisions is the timing of the 30 day period. To recover possession of unpaid goods, the supplier must make a written demand for repossession within 30 days *from the delivery of the goods* to the insolvent purchaser. The time frame is not calculated from the standard BIA formulation of the date of the insolvency filing. A more readily-understandable formulation would protect goods shipped within 30 days *prior to the bankruptcy or the receivership*. Suppliers frequently get caught short under the current system. For example, if a purchaser goes into bankruptcy or receivership 26 days after the supplier's goods have been shipped, the supplier will have only four days to make a demand for repossession to protect its "30 day goods rights," assuming the supplier is even notified within that time frame that a bankruptcy or receivership has taken place. Consequently, "30 day" goods rights in the current system is a misnomer.

Unpaid suppliers rights are also undermined by the statutory requirement that the goods be "identifiable as the goods delivered by the supplier". Regrettably, some insolvency representatives have gone to considerable lengths to complicate the rights of unpaid suppliers by, for example, insisting on serial numbers for goods that have been supplied to

the insolvent purchaser. In other cases, even minimal identification requirements may be impossible to satisfy as, for example, in the case of suppliers of generic goods such as lumber or produce. If the current unsatisfactory and unfair system is retained, it should be modified to allow unpaid suppliers to recover for unpaid generic goods without the inequity of going through a legislatively-imposed widget-by-widget identification process which, in fact, excludes unpaid suppliers of generic goods from virtually every opportunity for recovery.

One of the basic objectives of a restructuring is to provide a better recovery for creditors than if the debtor had gone bankrupt. Ironically, because 30-day rights do not exist in reorganizations, suppliers who would have enjoyed these recovery rights in a liquidation will usually find that they are being offered in a restructuring much less than the overall recovery they would have received than if there had been a bankruptcy. This is a perverse incentive which promotes liquidations over reorganizations and is inconsistent with the thrust of both the BIA and the CCAA which is to promote and encourage reorganizations and restructurings for the benefit of all of the stakeholders of a financially-troubled business. The situation does not make sense and should be changed.

There are several options that would bring equity to the 30-day goods system. For example, in reorganizations the right to recover unpaid 30-day goods could be replaced by a lien for the value of unpaid goods that have been used in the reorganization. In that way, the reorganizing business could have the benefit of the goods, but the supplier of the goods would ultimately be paid for them. In comparable circumstances, the BIA in fact provides for such a lien in favour of farmers and fishermen for products that are delivered within 15 days preceding the insolvency of their purchaser. This lien is given priority over all other liens against the inventory of the purchaser. There is no conceptual reason why this formulation could not also apply in the case of 30-day goods.

The rationale for the grant of a measure of protection to suppliers to an insolvent business extends to similarly vulnerable trade creditors who supply services. The distinction between suppliers of goods and suppliers of services within 30 days of bankruptcy has never been clear. Since the

legislative intent of these provisions is to protect those who provide credit to a business within 30 days of its ultimate insolvency, there is no reason in principle why this protection should not also extend to other suppliers of credit as well. In contentious cases, the court would rule on the propriety of claims for pre-bankruptcy goods or services which would eliminate potential abuse from the system.

Canadian legislative policy was made very clear in the 1992 amendments to the BIA. Canada's existing legislative policy is to protect unpaid suppliers to an insolvent business who supply within a relatively short period prior to the insolvency. The goals intended for this policy have not been achieved in practice. Reforms are needed so that the protections provided by Parliament are actually available in practice. Suppliers of goods and services are equally deserving of the benefit of such reforms.

3. *Creditors' Committees*

Canada's insolvency systems have always been intended to be creditor-driven. The BIA has been described as a "businessmen's Act" which is intended to allow creditors and their insolvent debtors to reach commercial accommodations where a debtor does not have sufficient assets to pay all of its liabilities in full. The means by which creditors in most jurisdictions express their views and present their collective positions in the proceedings is through a creditors' committee structure.

The BIA contemplates creditors' committees of a sort in liquidations. In BIA reorganizations, the rights of creditors to organize themselves effectively in committees is restricted and, in the CCAA, the right of creditors to organize themselves into committees is not even provided for or recognized. In BIA proposals, creditors are entitled to elect inspectors but the debtor company can restrict the powers of the inspectors in its proposal so the creditors have no independent ability to act beyond the powers that the debtor company provides to them in the proposal. The presence in liquidations of a form of a creditors' committee reflects a policy decision, which the Equifax National Insolvency Group endorses, that

creditors should have an effective statutory right to participate in a business reorganization that will inevitably compromise their rights.

The BIA situation can be contrasted with that of the CCAA. There is no provision for the appointment of inspectors or of creditors' committees in the CCAA. This is also in stark contrast with proceedings commenced under Chapter 11 of the United States Bankruptcy Code and in proceedings in a variety of other countries, where creditors' committees are appointed as a matter of course. There have been attempts (which have usually been unsuccessful) to form creditors' committees in CCAA proceedings. The difficulty is that because there is no statutory framework for creditors' committees, the makeup, role, function, funding for, and legal status of such committees seem to provide too many uncertainties for the courts to deal with.

In a small number of CCAA reorganizations, creditor committees have been appointed by the court but these appointments have almost always been made with the consent of the reorganizing business. The ability of creditors to organize themselves into representative committees in the CCAA, consequently, depends upon the sufferance of the reorganizing business and this sufferance will usually be influenced by prior-ranking creditors persuading or compelling the reorganizing business into resisting attempts to allow the unsecured creditors to organize in that fashion.

The Equifax National Insolvency Group strongly endorses the concept of creditors' committees as a matter of equity and good public policy. Creditors' committees are the essence of creditor participation and democracy in reorganizations and Canadian legislation should enhance creditors' committees and facilitate their formation and operation.

The value of creditors' committees stems from the unique and vulnerable position of unsecured creditors in a restructuring. The unsecured creditor class usually includes more creditors in number, if not dollar value, than the other classes of claims against the debtor. In addition to being the most numerous participants in the process, they are also the most vulnerable. At a minimum, unsecured creditors should have the right to organize to protect their interests and their rights to participate

in restructurings in a meaningful way in the same fashion as other creditors protect their interests and participate in restructurings that affect their rights and positions.

A properly constituted creditors' committees system will greatly enhance fairness in the Canadian insolvency regime. At the same time it will allow the lower-ranking and frequently ignored stakeholders to feel that they have a voice in the system and that their concerns are being addressed. This, in turn, would create a "buy in" to the process and reduce the frustration and cynicism that has become the norm amongst unsecured suppliers of goods and services in Canadian restructurings.

One of the contentious issues the concept of creditors' committees raises is the question of the expenses associated with committees. In a limited number of cases where the debtor and the higher-ranking creditors consented, CCAA court orders appointing a committee have included provision for the payment of legal and financial advisory costs incurred by the committee. Generally however, unsecured creditors are left to make their own arrangements among themselves to cover their expenses. It is curious and anomalous, in view of the issue of the cost of committees, that the courts in CCAA cases are quite willing to appoint "representative counsel" to represent the interests of particular groups of creditors and to require the reorganizing business to absorb their costs and such other professional advice as the counsel may require while declining to appoint a creditors' committee.

In United States practice, an Official Committee of Unsecured Creditors is automatically formed shortly after the filing of a case and consists of the largest seven unsecured creditors of the debtor who are willing to serve on the committee. This timing of the creation of the creditors' committee has another advantage over Canadian practice in that the creditors' committee is active from the earliest stages of the case, without the need to wait, as in the case of a BIA reorganization for a meeting of creditors.

In CCAA practice, of course, a meeting of creditors is not held until the debtor's Plan has been negotiated and formulated so there is no earlier opportunity for the creditors to constitute a creditors' committee to

participate in the negotiations on the Plan. The U.S. experience could be adapted to the Canadian system by the simple expedient of having the seven largest creditors of the reorganizing business form a creditors' committee as soon as possible after the insolvency filing with the appointment to be confirmed at the first meeting of creditors.

In the Canadian system, the funding and ability of stakeholders to participate in insolvencies and reorganizations produces a distinct anomaly in its refusal to permit unsecured creditors to enjoy organized participation in the insolvency system. Under the existing Canadian system, secured creditors who are in first place in the ranks of creditor priority effectively have their professional costs paid from the assets under administration. Their costs are typically added to the secured debt and are, of course, paid before there is any distribution made to unsecured creditors. The reorganizing debtor's professional costs, and the professional costs of Monitors and Trustees are also paid from assets under administration. Consequently, the argument that representation of unsecured creditors is too expensive for the Canadian insolvency system rings hollow. Creditor representation seems to be only too expensive where it involves representation of unsecured creditors and, of course, unsecured creditors are the very class of creditors that are most in need of representation in the insolvency process. Without a funding mechanism similar to that enjoyed by other stakeholders, unsecured creditors will continue to be denied the opportunity to participate effectively in the Canadian insolvency process.

Again, the contrast with the role that creditors' committees play in reorganizations in the United States makes a devastating comparison to the Canadian system. In the United States, creditors' committees are active and involved in reorganizational and liquidational cases. They have independent status to appear before the court on matters that affect the interests of creditors generally and to retain professional advisors as appropriate and as sanctioned by the court. For these reasons, U.S. creditors' committees are generally actively and constructively involved in the administration of the case and the development of the reorganizational Plan. This enhanced level of presence and visibility in U.S. reorganizations means that unsecured creditors in Chapter 11 proceedings typically receive

dividends on their claims at a much higher level than their Canadian counterparts. As a general observation, unsecured creditors in large Chapter 11 cases *almost always* seem to receive a distribution on their claims while unsecured creditors in most Canadian CCAA cases *almost never* receive a distribution on their claims. There may be other reasons for this but, clearly, where a group of creditors is enfranchised to participate in the insolvency process, they will be treated better than if they had no such right.

4. *The CCAA Monitor: A Failed Concept*

Under the CCAA, every CCAA reorganization requires the appointment of an official called a “Monitor”. The creation of the position of Monitor predated the amendments to the CCAA which provided statutorily for it. The adoption of the function of Monitor into the CCAA was simply a legislative recognition of the practice that had developed earlier.

Monitors were used in the early stages of the modern development of the CCAA to give an assurance of credibility for a CCAA reorganization to the creditors of the reorganizing debtor. The concept was that a responsible person was available to report to the court if there were instances of overt impropriety on the part of the debtor during the reorganization. The object, in simpler terms, was to provide some minimal level of assurance that a reorganizing debtor would not carry on improper and prejudicial activities (e.g., disposing of assets) during the course of its reorganization. The Monitor was intended to be the CCAA equivalent of a trustee in bankruptcy in a BIA proposal.

Because creditors’ expectations of Monitors were reasonably modest (i.e., to prevent improper dispositions of assets), the practice developed that, for the sake of convenience, the auditors of the reorganizing business (in their quality as licensed trustees in bankruptcy) would be able to perform the low-level obligations that were expected of Monitors. This was a curious development and was justified on the basis that there would be savings in expense because the Monitor/auditor would already be familiar with the business of the reorganizing debtor and their integrity

would be assured because they were licensed by the Superintendent of Bankruptcy. Moreover, it was said, because the Monitor would be appointed by the court in the initial CCAA Order, they would have fiduciary obligations to all creditors of the reorganizing debtor and would be able to place examples of any improper conduct on the part of the debtor before the court for the appropriate remedial action. (Note that this rarely happens in practice).

It was not expected that Monitors would be anything more than “whistle blowers” in the event of improper conduct by the debtor during a reorganization. Consequently, very little of a positive nature was ever expected of Monitors in the early stages of their development.

As modern reorganizations became more complex in terms of structure, composition of creditor groups and increasing international aspects, the function of the Monitor did not and perhaps could not adapt to the growing need to positively represent the interests of creditors in a reorganization (as opposed to performing the negative function of seeing to the avoidance of impropriety). Because Monitors were almost always the auditors of the company, they were the people who had typically been called on first to assist the company in identifying solutions to its financial difficulties. This role was consistent with their statutory and professional responsibilities as auditors of the reorganizing company but, structurally, the role of the Monitor began to develop into that of a Plan proponent. This role usually conflicted with the fiduciary responsibilities of the Monitor which were to advance the interests of the creditors of the company. This dual role was justified on the basis that a reorganization would produce higher returns through the maintenance of going concern values so that in advancing the interests of the company in developing a successful plan, the Monitor/auditor was in fact advancing the interests of the creditors.

This can be seen as a fallacious self-justification. *Everyone* wants values enhanced in a reorganization and the universal debate in reorganizations is on how values should be maximized. In that debate, Monitor almost always end up on the side of the reorganizing company, arguing and contending against positions put forward by those to whom, as a result of its appointment by the court, it owes fiduciary

responsibilities. A successful Plan put together by the company with the assistance of the Monitor/auditor would, if it preserved going concern values and eliminated the risk of liquidation values, certainly produce a better result for creditors generally than a liquidation. The Monitor's primary objective, however, is always to produce a successful Plan on behalf of the company. This goal only coincidentally serves the interests of the creditors as the Monitor's primary objective is not to achieve the highest return for the unsecured creditors but to get the unsecured creditors to accept the smallest available recovery consistent with achieving a successful Plan of Reorganization.

As reorganizations became more sophisticated, as the number of financial institutions in Canada became more concentrated and as more foreign institutions entered the lending and finance market in Canada, the role of the Monitor as an independent fiduciary representing the creditors suffered more and more setbacks. With accounting firm mergers, it became quite clear that there was a highly limited number of professional organizations that could accept a role as a Monitor in a complex CCAA reorganization. All of those organizations had close and lengthy relationships with the major institutions in the financial services area.

Because of the growing concentrations in lending and financial services, it became common for major creditors to insist, as a condition of supporting a reorganization, that their particular choice of professional services firm be appointed as the Monitor in the proceeding. This added another set of conflict issues. In addition to the Monitor/auditor combination, there began to be a different combination, the lender-agent/Monitor.

In its own way, the lender-agent/Monitor concept was even more flawed than the Monitor/auditor concept. Clearly, under the present CCAA system in which it is virtually impossible to find replacement financing or to obtain priority financing on an emergency basis for temporary cash flow requirements, the existing lenders to a business (and often there is only a single lender) play a dominant position in the reorganization. In a sense, the lenders to a reorganizing business are often more important players in the reorganization than the company itself. The relationships of lender-agent/Monitors to most of the primary institutions

in the financial services area in Canada involves protecting and advancing the interests of the lender. It is impossible to see how a lender-agent/Monitor can discharge the functions of a fiduciary to the unsecured creditors of a reorganizing business.

The apogee of the inconsistency of obligations in the development of the concept of the Monitor has not yet been reached in this narrative. That apogee is reached when the Monitor as the fiduciary to creditors accepts an appointment as a receiver or receiver and manager on behalf of a secured creditor. In this situation, the officeholder is expected to observe fiduciary responsibilities to all creditors as Monitor and, inconsistently, to carry out the responsibilities necessary to protect the interests of the secured creditor who sought the appointment. (For a statement of the powers of a court-appointed receiver, any recent standard court receivership order will leave no doubt that the interests of the secured creditor are to be the paramount, if not the exclusive, concern of the court-appointed receiver). It is quite clear that, upon the appointment of a receiver, the responsibilities of the officeholder to those who provided goods and services to the debtor on an unsecured basis, are essentially at an end. This result has, in part, been promoted by the failure of Canadian insolvency systems and procedures to provide clear rules dealing with fiduciary duties and conflicts of interest.

In the final analysis, most other systems, but especially the United States system, provide more transparency and are much freer from conflicts of interests than the Canadian system. In Canada, post-Enron, major changes in corporate and professional responsibilities have emerged to protect shareholders but no improvements have been suggested for the protection of unsecured creditors who by definition are almost as vulnerable as shareholders. This situation must be reformed. Canada should be able to devise a standard of independence that would ensure that insolvency officeholders are free from other interests and other relationships that might impact on their objectivity and their ability to serve the creditors they are appointed to represent.

5. *Independence and Accountability of Insolvency Representatives:
Fiduciary Duties and Conflicts of Interest*

There seems to be confusion between the concept of fiduciary obligations on the one hand and the concept of conflict of interest on the other. An obligation to act as a fiduciary places a higher level of responsibility on an officeholder than does a requirement to simply avoid a conflict of interest. A fiduciary owes the highest duty of care and loyalty to those to whom it is in a fiduciary capacity. The obligation of a fiduciary is to place the interests of those to whom it acts in a fiduciary capacity ahead of all other interests including its own interests and certainly the interests of others that have conflicting interests to those of the parties to whom the officeholder is fiduciary.

To illustrate the contrast, acting in a conflict of interest would be in breach of the fiduciary obligations of an officeholder but, as well, advancing the interests of someone whose interests are inconsistent with those to whom the officeholder is fiduciary would also be in breach of its fiduciary obligations. It is therefore abundantly clear that an officeholder cannot owe fiduciary obligations to separate classes or categories of beneficiaries whose interests are inconsistent with each others. The officeholder simply cannot promise each class to pursue their interests at the expense of the other.

Yet this is where Canadian insolvency practice has ended up. CCAA Monitors are expected to act in a variety of inconsistent and conflicting roles. It is commonplace for Monitors to act as a financial consultant to the debtor, as a financial consultant to the secured creditors of the debtor, as a trustee in bankruptcy representing the interests of unsecured creditors, or as a receiver or receiver and manager representing the interests of secured creditors. It is not unusual for a Monitor to occupy one or more of these roles in sequence as a case develops and there are examples of Monitors occupying all of these positions *at the same time*.

Some of the justifications usually given for multiple conflicting responsibilities is that (1) full disclosure has been made and (2) the court would not make an appointment that was improper in the circumstances. Neither of these bases provides a satisfactory justification. Disclosure to one class of

beneficiaries that the officeholder intends to act in a manner that is inconsistent with their fiduciary entitlement or their interests generally can hardly justify acting in breach of fiduciary obligations. The fiduciary obligations of officeholders are to place the interests of those to whom they are fiduciary above all others, not to simply advise them when they are not going to do so. Moreover, in the creditors' rights context, unsecured creditors as a large, unstructured group of independent entities are almost never in a position to provide an informed consent and, in reality, no effort is ever made to determine whether they would consent if they were given the opportunity. There may be situations in which unsecured creditors would agree or acquiesce that an officeholder that owes them fiduciary responsibilities might act in a different capacity but, at the moment, there is no statutory mechanism available through which the ordinary creditors of the estate can be represented in a discussion or decision regarding those issues. In fact, the only representative of the creditors generally in these situations is, almost invariably, the officeholder itself.

As to the Court approving these kinds of appointments, the Court is constrained by the record before it and that these applications are made on a basis which is *ex parte* as regards the general creditors of the business. No one speaks for the general creditors. These kinds of situations, have, unfortunately, become commonplace in recent years and, as a result, a pattern of acceptability of these kinds of arrangements has emerged and these issues are no longer explored in these kinds of applications. It is instructive to remember that in early cases prior to the adoption of the amendments that permitted auditors to be Monitors, there were in fact court decisions that took the view that auditors *could not* be Monitors because of the inconsistent responsibilities of the positions involved.

Consequently, the existing structure under the CCAA and, to a lesser extent, in the BIA actually enshrines a system that permits and perhaps even encourages breach of fiduciary obligations and conflicts of interest. This is what might well be expected of a third world country rather one which has one of the largest, most modern commercial economies in the world. Internationally, the current system is an embarrassment to Canada. Domestically, the system connotes unequal treatment of creditors involved in Canadian insolvency cases and implies a lack of integrity in the public administration of our insolvency systems.

The solution is two-fold. The primary solution is to provide a means of representation for the general body of creditors through the formation of creditors' committees. Creditors' committees are essential to preserve and maintain the interests of the general creditors in CCAA reorganizations. This would simply give a voice to the stakeholders who are the residual beneficiaries of any increase in value in the estate and of any pursuit of remedies available to the estate.

In another context, creditors' committees should be appointed in international cases to ensure that the interests of the general creditors of an estate in an international case are observed and not prejudiced in the case. In international cases under the CCAA and the BIA and otherwise, some assurance must be available to ensure that creditors' committees do not simply become clones of creditors' committee in another proceeding. To do this, guidelines should be adapted into the BIA and the CCAA relating to eligibility to act. These guidelines would also, of course, be highly useful in domestic administrations as well.

There is a dramatic need for improvement in the limited guidelines in the BIA regarding conflicts of interest and the duties of officeholders and the virtually non-existent rules on that topic in the CCAA. The United States Bankruptcy Code regulates responsibilities in insolvency situations so as to diminish the possibilities for conflict of interest and breach of fiduciary obligations by requiring officeholders and their advisors to be "disinterested" and to have no "connection" with any of the interested parties in the proceeding.

As professional associations pay more attention to the integrity of their systems, to the propriety of not acting in situations of conflict of interest and to not attempting to carry out conflicting representations, consideration has been given to defining the concept of "conflict of interest". Attached as a Schedule is an extract from the Rules of the Law Society of Upper Canada, the governing body of the Ontario legal profession, which defines conflict of interest for the legal profession in Ontario. This definition would seem to fit the obligation and responsibilities of all professionals.

It is strange and unusual that the Canadian insolvency system, which is so important to Canada's commercial framework and which involves such complex inter-relationships among stakeholders, has virtually no provisions dealing with

conflict of interest or the requirement that an officeholder representing creditors be free of other interests and representations. The only exception is the modest attempt made in the BIA to define circumstances in which a trustee may also act for a secured creditor. Clearly, this was a step in the right direction in the sense of enhancing and improving the integrity of the Canadian insolvency system and it addressed an issue that was current at the time but the need for clear demarcations of responsibilities among representatives of stakeholders in Canadian insolvency procedures now requires different and more effective provisions to maintain the equitable balance in the Canadian system among the stakeholders as well as the integrity of the administration of Canadian insolvency systems generally.

6. Information Availability for Creditors in Insolvency Cases

A number of relatively minor changes should be made to encourage and enhance opportunities for creditors to participate in the insolvency process. These modest changes would have a very positive impact on the Canadian insolvency process.

The BIA should be clarified so that the trustee is required to provide known creditors with the insolvent debtor's complete initial filing and not merely the "notice of intention" which is simply a one page form. Although many trustees do this already, the amendment would create clarity and consistency.

Material adverse change reports in bankruptcies should be sent to creditors. One of the trustee's most important ongoing responsibilities is to monitor the debtor's business and financial affairs and to ascertain any material adverse changes in projected cash flows or financial circumstances. As presently drafted, BIA requires only that the trustee file the material adverse change report with the Official Receiver and the Court. A trustee in a proposal should be required to immediately provide material adverse change reports to creditors directly affected by the change. In the absence of this type of information, creditors have little ability or motivation to participate in the process by supporting or opposing the debtor's reorganization.

Two relatively minor amendments to CCAA procedures would similarly enhance the flow of information to creditors. A debtor seeking CCAA protection from creditors should file a list of its largest creditors as part of its initial application to the court. This change would be consistent with the BIA's provisions and would provide the creditors with an early opportunity to identify each other, organize, and if desired, participate in the process.

This amendment is necessitated because in Canada, unlike in the United States, there is no consistent approach to the notification and disclosure of significant creditors in the early stages of a CCAA reorganization. In practice, not only do CCAA filings not disclose the identity of creditors generally, there have been instances in which Monitors in CCAA proceedings have actually *refused* to provide that information to creditors. Ultimately, an effective restructuring process should not permit the debtor to strategically withhold information that would facilitate creditor participation in the process. The disclosure of the identities of the debtor's largest creditors requires very little effort on behalf of the debtor and would facilitate the flow of information amongst those larger stakeholders who are most likely to wish to participate constructively in the process.

As Canadian reorganizations, particularly under the CCAA, become more complex and lengthy, a reorganizing business can often carry on business in a reorganization for several months or even a year or more. During that period of time, a large and complex business will continue to generate internal financial statements on a weekly, bi-weekly, monthly and quarterly basis but, in practice, these reports are never provided to the creditors. There are, in fact, instances in which Monitors have refused to provide current financial information in their possession to creditors of the company under any circumstances. Consequently, creditors are unable to gauge the financial performance or condition of the company. In an insolvency, the residual owners of the company are, of course, its creditors and it seems anomalous that the current insolvency system allows the debtor and the Monitor (who is appointed to represent the interests of the creditors) to withhold current financial information in an ongoing case

from the creditors. Clearly, the CCAA should require regular monthly financials to be provided to the creditors of the reorganizing business.

Another technical amendment that would improve the flow of information to creditors in a CCAA context would require the debtor or the Monitor to post copies of all notices, court filings and orders on a publicly-accessible website. The Canadian court system, particularly in insolvency, is woefully short of electronically accessible court filings. The volume of paper generated in the course of a modern day CCAA proceeding is enormous and grows quickly. Particularly in the case of the larger and more complex reorganizations, many of which have cross-border aspects, there is simply no efficient way of making timely disclosure of important information short of a website posting. The establishment of a website, and a provision for service on interested parties by email is the modern and cost-efficient way to disseminate important information to the hundreds and sometimes thousands of stakeholders impacted by a financial restructuring.

7. Protection for Reorganization Period Credit

There is a strange and unfair neglect in Canadian insolvency systems for suppliers who provide goods and services to a reorganizing business that is operating under the protection of the BIA or the CCAA. Where a reorganizing company operates under the protection of the Court and under a legislative system designed to allow the business to achieve financial rehabilitation through a reorganization, virtually everyone who does business with it after the commencement of the reorganization does so on the basis that our insolvency system will permit them to be paid for the goods and services they supply. Unfortunately, this is not the case. There have been at least two recent reported decisions under the BIA and there is considerable anecdotal experience under the CCAA to indicate that suppliers who provide goods or services to a reorganizing business are not assured of being paid for their goods and services in the event that the reorganization fails. The justification given in the two BIA decisions referred to above is that there is simply no statutory priority in the BIA for reorganization-period credit.

Creditors who supply goods and services to a reorganizing company during its reorganization are, of course, contributing to the prospective success of the reorganization and are putting additional resources at risk in doing so. On their pre-filing claims, they have already sustained a loss in doing business with the reorganizing debtor. It seems unfair and inimical to the legislative intent of our bankruptcy and insolvency systems, which is to promote opportunities for businesses to financially reorganize, for creditors who supply to a business during its reorganization to be put at greater risk for attempting to assist in the survival of the business than those who do not.

The problem, of course, would be solved if suppliers took advantage of the permissions in the BIA and the CCAA to deal with a reorganizing business only on c.o.d. terms. This, however, would have a significant negative impact on *all* reorganizations. It would be strange for Canadian commercial public policy to restrict the availability of credit to companies that are attempting to financially rehabilitate themselves through processes of the BIA or the CCAA. But that is exactly the current position that the BIA and the CCAA are forcing on reorganizing businesses and their suppliers. The clear objective of Canadian reorganizational legislation is to permit a financially over-committed business an opportunity to negotiate a composition with its creditors and carry on in business, and, consequently, a structure that imposes a requirement that post-filing transactions be conducted on a cash basis is highly inconsistent with these legislative goals.

Again, in the United States Bankruptcy Code, providers of goods and services to reorganizing companies are given the benefit of an “administrative priority” charge ahead of other pre-filing unsecured creditors. This encourages suppliers to extend credit to companies in a reorganizational mode and facilitates financial reorganizations instead of putting creditors who do business with a reorganizing entity in a worse position than those who do not.

8. *Conclusion*

The foregoing submissions are an attempt to describe several of the major areas in which improvement must be made to Canada’s legislative insolvency system to promote a higher degree of equitable treatment to general creditors of reorganizing and liquidating businesses and to

improve the transparency of Canadian insolvency processes. The fact that many of these areas of improvement involve the position of suppliers and other unsecured creditors shows that the Canadian insolvency system does not yet have the proper balance between secured and unsecured creditors.

This Committee's consideration of the improvements needed to Canada's bankruptcy and insolvency system is a rare opportunity for Canada to ameliorate the existing deficiencies and shortcomings in its present insolvency and reorganizational processes. The task is complex and the challenges in devising a system for reorganizations and insolvencies which is fair, effective and transparent should not be underestimated. The authors believe that Canada can have one of the finest insolvency systems in the world and believe that it should not from the opportunity and the responsibility of making the changes that would enable Canada to achieve and enjoy the benefits of an improved insolvency and reorganizational system.

RESPECTFULLY SUBMITTED on behalf of the Equifax Canada Inc. National Insolvency Group by:

E. Bruce Leonard
Melvin C. Zwaig
David S. Ward

Toronto, Ontario
September 26, 2003

Schedule "A"

Extracts from the Law Society of Upper Canada Rules of Professional Conduct

2.04 AVOIDANCE OF CONFLICTS OF INTEREST

Definition

2.04 (1) In this rule,

a "conflict of interest" or a "conflicting interest" means an interest

(a) that would be likely to affect adversely a lawyer's judgment on behalf of, or loyalty to, a client or prospective client, or

(b) that a lawyer might be prompted to prefer to the interests of a client or prospective client.

Avoidance of Conflicts of Interest

2.04 (2) A lawyer shall not advise or represent more than one side of a dispute.

2.04 (3) A lawyer shall not act or continue to act in a matter when there is or is likely to be a conflicting interest unless, after disclosure adequate to make an informed decision, the client or prospective client consents.