BUSINESSES IN CRISIS:

THE EVOLUTION OF CROSS-BORDER INSOLVENCY LAWS AND PRACTICES

IN THE

UNITED STATES AND CANADA

Presented by: Pamela J. Starr

Thomas Jefferson School of Law - LL.M./J.S.M. Program

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Professor: Johan Jol

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INTRODUCTION

We live in a much different world than that of the founding fathers. International commerce and business models have evolved in ways that, perhaps, only Ben Franklin may have foreseen - information is transferred almost instantaneously, distance and borders have been redefined, and filing for bankruptcy protection has (unfortunately) become a routine occurrence.

The growth of the Internet has allowed businesses to flourish throughout the world. Corporations maintain offices in multiple states and countries, conducting any manner of transactions with partners and/or competitors, located anywhere on the planet, virtually, in real time. Money is made and lost in a nanosecond … companies rise and fail. Laws addressing the issue of international trade and commerce have long been written into US and Canadian legislation, as have been laws to ease the transition of businesses in distress. The faltering world economy has set the stage for a rise in cross-border corporate filings for liquidation and reorganization under various bankruptcy laws.

❖ A CONDENSED HISTORY OF BUSINESS BANKRUPTCY PRACTICES IN THE US & CANADA

The laws governing bankruptcy were developed to protect both the debtor and creditor … although history shows that the US system was more receptive to the establishment of a formal system of bankruptcy laws than were our 'neighbors to the North.'

➢ THE UNITED STATES BANKRUPTCY CODE

Until the adoption of the Bankruptcy Clause of 1787, the bankruptcy laws of the newly established Republic were substantially similar to English law of the time. In 1800, the Bankruptcy Clause became the Bankruptcy Act.[1] The Bankruptcy Act of 1800 was repealed,

[1] Vile, J. R. (2005). Appendix A-Z; "Bankruptcies". *The Constitutional Convention of 1787: a comprehensive encyclopedia of America's founding* (p. 47). Santa Barbara, Calif. [u.a.: ABC-CLIO.]

revised, and amended over the next 178 years, ultimately becoming the Bankruptcy Reform Act of 1978 and the Bankruptcy Code. 1978 Act was also revised and amended several times and, in 2005, it was amended to create the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"). As with most laws, BAPCPA has also seen its share of amendments and revisions, including several that became effective as recently as December 1, 2011.

The various versions of what is now referred to as the Bankruptcy Code ("the Code") define the structure of the court system, the parties, timelines, process, etc. Procedures are set out under the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules" or "F.R.B.P.") and may be further defined by the local rules of each judicial district. The Code, and its relative protections, is divided into chapters, sub-chapters, and sections; within those chapters are the various protections proffered by the Code:

- Chapter 7 - Liquidation;
- Chapter 9 - Adjustment of Debts of a Municipality;
- Chapter 11 - Reorganization;
- Chapter 12 - Adjustment of Debts of a Family Farmer or Fisherman with Regular Annual Income;
- Chapter 13 - Adjustment of Debts of an Individual with Regular Income, and
- Chapter 15 - Ancillary and Other Cross-Border Cases.[2]

Pursuant to the definitions found at 11 U.S.C. ' 101 (13), a debtor is defined as a "person or municipality concerning which a case under this title has been commenced." The term "person" is further defined 11 U.S.C. ' 101 (41) as an "individual, partnership, and corporation, but does not include governmental unit…"[3] Therefore, a business may file for relief under either Chapter 7 or Chapter 11 of the Bankruptcy Code. Businesses who desire to simply liquidate and reduce their losses, often file under Chapter 7; those that wish to stay in business (and some that

[2] Generally 11 U.S.C.
[3] Note: there are limitations and exceptions under this sub-section.

wish to liquidate) file for reorganization under Chapter 11. Oddly enough, neither the terms 'bankrupt' or 'bankruptcy' are defined by the Code.

- **CHAPTER 11 - A BRIEF OVERVIEW**

A Chapter 11 is commenced when a qualified entity, or, under certain circumstances, a group of creditors[4] files a petition to either liquidate or reorganize; schedules of assets and liabilities; current income and expenditures; executory contracts and unexpired leases; and a statement of financial affairs, along with a slew of 'First Day Motions,' including specific requests for financing to allow the business to continue normal operations. The act of filing immediately imposes an automatic stay with regard to all collection activity and litigation involving the debtor. It also creates the 'bankruptcy estate'[5] and gives the debtor a new identity and role as the "Debtor in Possession" ("DIP"). As the DIP, the debtor maintains possession and control of its assets while undergoing Chapter 11 reorganization without the appointment of a trustee.[6]

Under the Code, the DIP has the exclusive right to file its own Plan of Reorganization within the first 120 days after filing. By motion and order, the DIP can extend the period up to 18 months. The Plan, along with a Disclosure Statement, is then evaluated and voted upon by the creditors. Ultimately, the Court will enter an order either confirming or rejecting the Plan. Operating under its confirmed Plan, the DIP has the opportunity to reorganize its business operations by discharging certain debts; paying remaining obligations in part or in full; assuming, rejecting, or assigning executory contracts and/or unexpired leases; and taking other actions to recover assets. The process is time consuming and expensive, but many Debtors emerge from Chapter 11 with newly organized, profitable businesses.

[4] 11 U.S.C. § 301
[5] 11 U.S.C. § 541 - Property of the Estate
[6] 11 U.S.C. § 1101

➢ THE CANADIAN BANKRUPTCY AND INSOLVENCY ACT

As stated earlier, it took a bit longer for Canada to implement its own set of bankruptcy and insolvency laws. In 1869, the Parliament of Canada enacted the first bankruptcy legislation known as Insolvent Act of 1869 which morphed into the Insolvent Act of 1875. The Insolvent Act of 1875 was repealed in 1880 and there was no bankruptcy legislation in place until the Canadian Parliament ratified the Bankruptcy Act of 1919. Much like the bankruptcy laws in the US, the Canadian Bankruptcy Act has endured a series of amendments and revisions. In 1992, the Act of 1919 was renamed the Bankruptcy and Insolvency Act ("BIA")[7]. The most recent and significant revisions to the BIA occurred in 2005 and 2007.

Canadian bankruptcy and insolvency laws are divided into several acts including the Bankruptcy and Insolvency Act ("BIA"), the Companies' Creditors Arrangement Act ("CCAA"), and the Winding-up and Restructuring Act ("WURA"); furthermore, each province has its own set of laws with regard to bankruptcy and the resolution of debt problems. The BIA (comparable in many respects to a Chapter 7 filing in the US) is the primary framework by which an insolvent individual, corporation or partnership may liquidate its assets and equitably distribute the proceeds to its creditors. Unlike the US Bankruptcy Code, the BIA provides a process through which an insolvent party may avoid filing for bankruptcy through negotiation, compromise, and reorganization of its debts.[8] The CCAA is a separate act, which provides the opportunity for an insolvent company to reorganize and negotiate the settlement of its debts.

Under Canadian bankruptcy and insolvency laws, a person 'commits an act of bankruptcy'. The BIA defines the terms 'person', 'bankrupt' and 'insolvent person' as follows:

- "person" means a partnership, an unincorporated association, a corporation, a cooperative society or a cooperative organization, the successors of a partnership,

[7] "An Act Respecting Bankruptcy and Insolvency"; *Bankruptcy and Insolvency Act* (R.S.C., 1985, c. B-3)
[8] This alternate method is reminiscent of the BAPCPA requirement that individual debtors obtain credit counseling.

of an association, of a corporation, of a society or of an organization and the heirs, executors, liquidators of the succession, administrators or other legal representatives of a person;

- "bankrupt" means a person who has made an assignment or against whom a bankruptcy order has been made or the legal status of that person;
- "insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, …, and
  (a) who is for any reason unable to meet his obligations as they generally become due,
  (b) who has ceased paying his current obligations in the ordinary course of business as they generally become due, or
  (c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.[9]

- **THE COMPANIES' CREDITORS ARRANGEMENT ACT - A SYNOPSIS**

Companies' Creditors Arrangement Act ("CCAA") is defined as "[a]n Act to facilitate compromises and arrangements between companies and their creditors."[10] In many respects, the CCAA is seen as the Canadian equivalent of Chapter 11 of the US Bankruptcy Code. Unlike its US counterpart, the CCAA is composed of only 22 sections. This less formal structure has allowed Canadian courts to implement broad discretion when interpreting the Act as well as adapting the application of the law to complement the unique circumstances of each case.

The matter is initiated by the filing of an application with the appropriate superior court. Unlike the Chapter 11 Petition, the application seeks an omnibus initial order for a comprehensive stay of proceedings and other relief. Once granted, the initial order provides a limited stay of 30-days, which may be extended upon application and order. The order also provides for the appointment of a 'monitor'[11], to manage the business and financial affairs of the company. The monitor will often help the debtor draft and submit a plan of arrangement or compromise to its creditors. An approved plan will allow the debtor to compromise its

[9] CCAA R.S.C., 1985, c. C-36, s. 2
[10] CCAA R.S.C., 1985, c. C-36
[11] CCAA R.S.C., 1985, c. C-36, s. 2

obligations and proceed with business. Once approved, the plan is submitted to the court for sanction. A sanctioned plan is binding upon all parties.

BUSINESS REORGANIZATIONS (GENERALLY)

	US - USBC/BAPCPA	CA - CCAA
DEBTOR	Corporation, sole proprietorship, or partnership, and in some instances, an individual[12]	Insolvent companies (or affiliated groups) with liabilities in excess of $5 million; not individuals[13]
PLACE OF FILING	Bankruptcy Court in the district in which the Debtor is domiciled or resides[14]	Superior Court for the province in which the company's head office/ chief place of business is located[15]
INITIAL DOCUMENTS	Chapter 11 Petition ***with*** notice to creditors; schedules of assets/ liabilities; current income/expenditures; executory contracts/unexpired leases; statement of financial affairs[16]	Application to the Court with***out*** notice to creditors; statement of projected cash flow; and copies of all financial statements for the most recent year available.[17]
EFFECT OF FILING	Automatic Stay immediately imposed upon filing petition; terminates upon motion or dismissal[18]	30-day stay imposed by order of Court following submission and review of Application; may be continued[19]
FIDUCIARY OFFICER	Debtor-in-Possession or Court may appoint Trustee[20]	Appointment of a Monitor, usually selected by the Debtor[21]
EXCLUSIVITY PERIOD	Debtor has exclusive right to file Plan of Reorganization in the first 120 days after filing the petition; may be extended for a total of 18 months [22]	N/A
PLAN	Plan of Reorganization must include a classification of claims, must specify the treatment of each class of claims and provide the means for implementation[23]	Plan of Compromise or Arrangement - no statutory restrictions on the structure or content of the Plan[24]
DISCLOSURE STATEMENT	Must contain adequate information about the Plan so creditors can understand and evaluate its feasibility; approved by the Court after notice and a hearing then distributed to creditors for voting [25]	N/A
ACCEPTANCE AND VOTING	Deemed accepted if creditors who hold (i) ⅔'s in amount, and (ii) ½ in number of the allowed claims in a class vote to accept or reject [26]	A majority of the creditors in each class by number, together with ⅔ of the proven creditors in that class by dollar value, must approve the Plan.[27]
CONFIRMATION	Confirmation hearing held following approval of the Disclosure Statement and the counting of the ballots; parties may object to Confirmation.[28]	Debtor applies to the Court for Sanction (approval) of the Plan following of the vote accepting the Plan [29]

[12] 11 U.S.C. § 109
[13] CCAA R.S.C., 1985, c. C-36, s. 3
[14] 28 U.S.C. § 1408
[15] CCAA R.S., c. C-25, s. 9. (1)
[16] 11 U.S.C. §§ 301, Fed. R. Bankr. P. 1002, 1004, 1006, 1007
[17] CCAA R.S., 1985, c. C-36, s. 10; 2005, c. 47, s. 127
[18] 11 U.S.C. § 362
[19] CCAA R.S., 2005, c. 47, s. 128, 2007, c. 36, s. 62(F); 2005, c. 47, s. 128
[20] 11 U.S.C. § 1101; 11 U.S.C. § 1107(a)
[21] CCAA R.S., 2005, c. 47, s. 131; 2007, c. 36, s. 72
[22] 11 U.S.C. § 1121
[23] 11 U.S.C. §§ 1122, 1123
[24] CCAA R.S., R.S., c. C-25, s. 4; R.S., c. C-25, s. 5.
[25] 11 U.S.C. § 1125
[26] 11 U.S.C. § 1126
[27] CCAA R.S., 1985, c. C-36, s. 6; 1992, c. 27, s. 90; 1996, c. 6, s. 167; 1997, c. 12, s. 123; 2004, c. 25, s. 194; 2005, c. 47, s. 126, 2007, c. 36, s. 106; 2009, c. 33, s. 27.
[28] 11 U.S.C. §§ 1128, 1129

❖ WHAT IS CROSS-BORDER INSOLVENCY?

According Hockly's Insolvency Law (8th ed.), "cross-border insolvency deals with a sequestration or a winding-up involving property or debts in a jurisdiction other than the one in which the relevant court order is granted. In cross-border insolvency therefore, the law of insolvency and winding-up intersects with the conflict of laws (private international law)."[30] Simply put, cross-border insolvency refers to an insolvency/bankruptcy proceeding involving more than one country. Ultimately, a cross-border insolvency action facilitates the resolution of bankruptcy/insolvency matters which involve businesses with interests, parties-in-interest, and creditors in more than one country. What is the solution when a multi-national company becomes insolvent and/or decides to file for bankruptcy protection?

❖ EVOLUTION OF CROSS-BORDER INSOLVENCY LAWS

➢ UNCITRAL

The United Nations Commission on International Trade Law (UNCITRAL) was created in the late 1960s to address the growing complexities in international commercial laws. In the last 20 years, several agencies have been established to focus on the issue of cross-border insolvency and to set standards for the treatment of distressed, multinational businesses. UNCITRAL on International Bankruptcy is the model law that codifies and, hopefully, simplifies the process by which cross-border insolvency matters are managed and resolved. Article 27 of the Model Law encourages cross-border cooperation and the use of cross-border agreements; it is also the standard upon which Chapter 15 of BAPCPA and Chapter 47 of the CCAA are founded.

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[29] CCAA R.S.C., 1985, c. C-36, s. 6

[30] Sharrock, R., & Linde, K. (2006). *Hockly's Insolvency Law* (8th ed.). Cape Town: Juta.

The development of cross-border insolvency laws follows the natural evolution of international comity. This reciprocity among the nations allows complex legal matters pending in, or involving, multiple jurisdictions to be heard and settled systematically and equitably. By codifying comity in matters of bankruptcy, the courts have provided a means to facilitate the resolution of bankruptcy and insolvency matters which involve business with interests and or creditors in more the one country.

- **CHAPTER 15 OF THE UNITED STATES BANKRUPTCY CODE**

The 2005 revision to the United States Bankruptcy Code formalized and replaced Section 304 with what is now known as Chapter 15. The purpose of Chapter 15 is to:

> (1) to promote cooperation between the United States courts and parties in interest and the courts and other competent authorities of foreign countries involved in cross-border insolvency cases; (2) to establish greater legal certainty for trade and investment; (3) to provide for the fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested entities, including the debtor; (4) to afford protection and maximization of the value of the debtor's assets; and (5) to facilitate the rescue of financially troubled businesses, thereby protecting investment and preserving employment.[31]

- **CHAPTER 47 OF THE STATUTES OF CANADA**

The Canadian Companies' Creditors Arrangement Act was also revised in 2005 to include a section on cross-border insolvency. Part IV of the CCAA states that:

> The purpose of this Part is to provide mechanisms for dealing with cases of cross-border insolvencies and to promote
>
> (*a*) cooperation between the courts and other competent authorities in Canada with those of foreign jurisdictions in cases of cross-border insolvencies;
>
> (*b*) greater legal certainty for trade and investment;
>
> (*c*) the fair and efficient administration of cross-border insolvencies that protects the interests of creditors and other interested persons, and those of debtor companies;
>
> (*d*) the protection and the maximization of the value of debtor company's property; and

[31] 11 U.S.C. § 1501

(*e*) the rescue of financially troubled businesses to protect investment and preserve employment.[32]

[32] CCAA R.S., 2005, c. 47, s. 131.

DEFINITIONS

	US - CHAPTER 15	CA - CHAPTER 47
DEBTOR	an entity that is the subject of a foreign proceeding[33]	Not specified
ESTABLISHMENT	any place of operations where the debtor carries out a nontransitory economic activity[34]	… a debtor company's registered office is deemed to be the centre of its main interests[35]
FOREIGN COURT	a judicial or other authority competent to control or supervise a foreign proceeding[36]	a judicial or other authority competent to control or supervise a foreign proceeding.[37]
FOREIGN MAIN PROCEEDING	a foreign proceeding pending in the country where the debtor has the center of its main interests[38]	a foreign proceeding in a jurisdiction where the debtor company has the centre of its main interests[39]
FOREIGN NONMAIN PROCEEDING	a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment[40]	a foreign proceeding, other than a foreign main proceeding[41]
FOREIGN PROCEEDING	a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation[42]	a judicial or administrative proceeding, including an interim proceeding, in a jurisdiction outside Canada dealing with creditors' collective interests generally under any law relating to bankruptcy or insolvency in which a debtor company's business and financial affairs are subject to control or supervision by a foreign court for the purpose of reorganization [43]
TRUSTEE	includes a trustee, a debtor in possession in a case under any chapter of this title, or a debtor under chapter 9 of this title [44]	Not specified
RECOGNITION	the entry of an order granting recognition of a foreign main proceeding or foreign nonmain proceeding under this chapter[45]	A foreign representative may apply to the court for recognition of the foreign proceeding in respect of which he or she is a foreign representative[46]
JURISDICTION	"within the territorial jurisdiction of the United States", when used with reference to property of a debtor, refers to tangible property located within the territory of the United States and intangible property deemed under applicable nonbankruptcy law to be located within that territory, including any property subject to attachment or garnishment that may properly be seized or garnished by an action in a Federal or State court in the United States[47]	Not specified
FOREIGN REPRESENTATIVE	a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the	a person or body, including one appointed on an interim basis, who is authorized, in a foreign proceeding respect of a debtor company, to (a) monitor the debtor company's business and

[33] 11 U.S.C. § 1502(1)
[34] 11 U.S.C. § 1502(2)
[35] CCAA R.S.C., 1985, c. C-36, s. 45 (1)
[36] 11 U.S.C. § 1502(3)
[37] CCAA R.S.C., 1985, c. C-36, s. 45 (1)
[38] 11 U.S.C. § 1502(4)
[39] CCAA R.S.C., 1985, c. C-36, s. 45 (1)
[40] 11 U.S.C. § 1502(5)
[41] CCAA R.S.C., 1985, c. C-36, s. 45 (1)
[42] 11 U.S.C. § 101(23)
[43] CCAA R.S.C., 1985, c. C-36, s. 47 (1)
[44] 11 U.S.C. § 1502(6)
[45] 11 U.S.C. § 1502(7)
[46] CCAA R.S.C., 1985, c. C-36, s. 46 (1)
[47] 11 U.S.C. § 1502(8)

	debtor's assets or affairs or to act as a representative of such foreign proceeding [48]	financial affairs for the purpose of reorganization; or (b) act as a representative in respect of the foreign proceeding[49]

❖ PRACTICAL APPLICATIONS OF CROSS-BORDER INSOLVENCY LAWS

The cross-border insolvency provisions for both the US and Canada allow 'the foreign representative of a proceeding in a foreign jurisdiction to apply to the court for recognition of the foreign proceeding and the orders made pursuant thereto.' In simpler terms, the courts of both nations have agreed to allow an ancillary matter to be heard upon application and approval to the court of the secondary country. For instance, the US bankruptcy court will permit the eligible foreign representative of a Canadian main proceeding to file a petition under Chapter 15 requesting that the Canadian proceeding be recognized and heard as an ancillary matter; conversely, the Canadian courts have agreed to allow a qualified foreign representative of a core proceeding in the US to submit an application for recognition so that the matter may be equitably adjudicated. Consider the application of a foreign representative on behalf of a core proceeding pending n Canada - once the foreign proceeding has been recognized by the US court, the US court will endeavor to cooperate and coordinate with the foreign representative and the Canadian court to facilitate the management and disposition of matter. The goal of Chapters 15 and 47, and other cross-border insolvency laws, is to "cooperate to the maximum extent possible" with 'foreign courts and foreign representatives and authorizing direct communication between the court and authorized estate representatives and the foreign courts and foreign representatives.'[50]

❖ CONCLUSION

Is the system perfect? In a word, no; however it is an improvement. As with all legislation, the bankruptcy and insolvency laws of the US and Canada will continue to evolve to embrace the continuing changes in the world economy.

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[48] 11 U.S.C. § 101(24)
[49] CCAA R.S.C., 1985, c. C-36, s. 45 (1)
[50] 11 U.S.C. §§ 1525 - 1527

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