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**RECENT CANADIAN TRANSNATIONAL
INSOLVENCY DECISIONS**

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1. INTRODUCTION

Over the last few years as more cases in Canada have involved cross-border issues, our courts have been struggling with the application of the concept of comity to increasingly complicated factual situations. In doing so, they have been interpreting new provisions in Canadian legislation aimed at improving the international insolvency landscape. This is particularly important for a country such as Canada which has extensive international trading relationships, and particularly in the context of its business connection with the United States, its largest trading partner. However, a generous application of the principles of comity sometimes can create perception problems for Canadian nationalists since it is difficult to avoid the reality that the US jurisdiction is almost invariably more significant than the Canadian jurisdiction from a purely financial perspective, and therefore in most cases, a pure application of universal insolvency principles would see Canada deferring to the US jurisdiction in most instances. The Canadian reluctance to give up complete autonomy to its large neighbour has, in the minds of some commentators, given rise to a somewhat schizophrenic approach in Canada to the comity issue, on the one hand accepting the general principle of comity, but on the other, applying it in a restrictive manner.

The key legislative provisions are found in the Companies' Creditors Arrangement Act (the "CCAA") and the Bankruptcy & Insolvency Act (the "BIA"). The relevant provisions in the BIA are contained in Part XIII which is entitled International Insolvencies. It contains provisions aimed at recognizing foreign stays, and contemplates ancillary proceedings, but it also specifically provides that "nothing in this Part requires the court to make any order that is not in compliance with the laws of Canada or to enforce any order made by a foreign court." Further, no foreign stay is effective against Canadian residents unless "the stay of proceedings is the result of proceedings taken in Canada." A more liberal provision addressing foreign insolvency proceedings is contained under section 18.6 of the CCAA, but again the legislation specifically provides that nothing "requires the court to make any order that is not in compliance with the laws of Canada or to enforce any order made by a foreign court." These restrictions have been used by Canadian courts to refrain from acknowledging foreign orders in circumstances where most commentators would probably have expected such acknowledgments to follow fairly automatically.

At last year's conference, commentators noted two very conflicting Canadian decisions in this context. The *Babcock*¹ decision of the Ontario court relied upon the principle of comity to permit an ancillary Canadian filing under the CCAA for the Canadian subsidiary of a US company which had obtained relief under chapter 11, notwithstanding that the Canadian company was solvent. Some Canadian commentators were surprised to see a foreign proceeding have such an effect on a solvent Canadian company, since under Canadian law, insolvency is a pre-requisite to relief under both the CCAA and the BIA. In contrast to the very generous application of comity in *Babcock*, in the *Singer*² decision, the Alberta court refused to recognize US Chapter 11 orders

¹ *Re: Babcock & Wilcock* [2000] 18 C.B.R. (4th) 157 (Ontario Supreme Court)

² *Re Singer Sewing Machine Co. of Canada Ltd.*, [2000] A.J. No. 212 (Q.L.) (Q.B.-R.)

in the context of Singer's insolvent Canadian subsidiary notwithstanding very wide-ranging orders made in the US proceedings seeking the assistance of foreign courts, and permitted a Canadian unsecured creditor to continue collection action against Singer's Canadian subsidiary, probably making Canada the only foreign jurisdiction which did not recognize and reciprocate the US orders in the *Singer* case, a surprising result given that Canadian and US restructuring systems are relatively similar. In *Singer*, the court stated that "comity does not require me to recognize a chapter 11 order over a Canadian company carrying on business only in Canada and whose assets are all in Canada. Who the shareholders are is irrelevant and who their creditors are is irrelevant. Under Alberta law neither gives an American bankruptcy court jurisdiction over Singer Canada."

The dichotomy of views expressed in these two cases does not make for a clear understanding of just what can be accomplished in the Canadian context where assistance from the Canadian courts is required by a foreign insolvency representative. However several cases decided since then seem to be developing what may be a uniquely Canadian approach to the principle of comity whereby the concept of "plurality" is adopted as a middle ground between the universal and territorial approaches to foreign recognition. The key distinction in a pluralist approach is the concept of co-ordination rather than subordination of proceedings in different jurisdictions. The inevitable result seems to be an increasing tendency on the part of Canadian courts to refuse to abandon complete jurisdiction to foreign courts, even where the foreign jurisdiction is predominant from an insolvency perspective, where there is any perceived Canadian interest to be protected by doing so. On the other hand, in the few cases where Canada is the predominating jurisdiction, Canadian courts have not been shy to exercise broad international jurisdiction and to request the assistance of foreign courts, nor have they been reluctant to ignore foreign judgments which appear to be in conflict with the restructuring decisions made by Canadian courts in the same context.

The plurality concept has been stated most authoritatively by our Supreme Court in the *Antwerp Bulkcarriers* case, summarized below. A cynic might say that in adopting this approach, the court is simply giving itself the discretion to go in either the universal or territorial direction, depending on the facts rather than adapting a firm rule which directs a consistent result irrespective of the consequences. If this is in fact true, it would be consistent with the general tendency in Canada to seek the middle ground where two conflicting approaches are available. The federal government is currently considering amendments to its insolvency legislation, including the foreign recognition provisions of the BIA and the CCAA, so it will be interesting to see if any amendments are ultimately proposed which produce a different result in future cross-border situations.

2. THE CASES

- (a) ***Re Antwerp Bulkcarriers N.V.*** (2001), 30 C.B.R. (4th) 68 (S.C.C.) and ***Holt Cargo Systems Inc. v. ABC Containerline N.V. (Trustees of)*** (2001), 30 C.B.R. (4th) 6 (S.C.C.)

These cases are companion cases of the Supreme Court of Canada ("S.C.C.") *Holt Cargo Systems* arrived at the S.C.C. on appeal from the Federal Court of Appeal in respect of an *in rem* claim against a ship, the M.V. *Brussel* (the "Ship"). *Re Antwerp Bulkcarriers* arrived at the S.C.C. on appeal from the Quebec Court of Appeal in respect of bankruptcy proceedings

initiated in Canada by the Trustees in bankruptcy of Antwerp Bulkcarriers N.V., owners of the Ship (also referred to as the “Owner”). The fact that there were two separate lines of cases dealing effectively with the same issue will no doubt be confusing to a non-Canadian, but this disability results from the division of powers under Canadian law between the federal and provincial court systems in respect of maritime and insolvency law issues.

The judgments, though different with respect to the Court’s recitation of the history and nature of the proceedings, and, to some extent, the weight of the various issues, are parallel in their result and in most respects similar. Accordingly, the cases are summarized as one and issues given more consideration in one judgment are so recognized.

Facts

The Owner was indebted to a U.S. Company, Holt Cargo Systems Inc. (“Holt”), in respect of unpaid fees for stevedoring and other related services supplied to the Ship by Holt at Gloucester City, New Jersey. By Canadian maritime law, this gave Holt a lien over the Ship. In order to enforce this lien, Holt had the Ship arrested in Canadian waters near Halifax harbour. Shortly thereafter, the Owner made an assignment in bankruptcy in Antwerp, Belgium, and trustees in bankruptcy (the “Trustees”) were appointed in relation to that assignment.

Under Belgian law, the Trustees were required to take possession of all of the Owner’s assets, wherever situated. These assets included the Ship. The Trustees filed applications in all jurisdictions in which the Owner’s assets were located seeking the release of such assets to the Trustees and directions that all claims against the Owner be directed to the Belgian bankruptcy court.

There were numerous motions in both the Quebec Superior Court (sitting in bankruptcy) and the Federal Court (exercising its jurisdiction over maritime issues) concerning the disposition of the Ship. The salient orders are as follows:

1. May 9, 1996 – The Quebec Superior Court recognizes and declares executory in Quebec the Belgian court’s bankruptcy order.
2. May 17, 1996 – The Federal Court orders the Ship appraised and sold.
3. June 11, 1996 – The Quebec Superior Court makes an order, the effect of which is to dispose of the Ship and the proceeds generated by such disposition for the benefit of the Trustees. The order was obtained by the Trustees *ex parte*, on which application the Trustees failed to inform the Court that the Federal Court had already ordered the Ship sold.
4. April 9, 1997 – The Federal Court denies the Trustees’ application for a stay of the order of sale based on the June 11, 1996 Quebec Superior Court order.
5. June 28, 1997 – The Quebec Superior Court makes an order clearly asserting control over the Ship. The order permits the sale of the ship provided that the proceeds of sale are turned over to the Trustees.

These orders were all appealed to the relevant Courts of Appeal, and the Ship was subsequently sold with the proceeds of the sale held pending disposition of further appeals to the S.C.C.

Summary

Binnie J.'s decision in *Holt Cargo Systems*, though divided into a number of discrete sub-issues, is essentially a consideration of the principle of “universality” in bankruptcy and insolvency proceedings on the basis of comity and the limits on the principle of universality. His judgment in *Re Antwerp Bulkcarriers* is mainly concerned with domestic comity (though it does consider the effect of the aforementioned issues, as well).

Although it was acknowledged that the Federal Court, in the *in rem* action, when faced with the Trustees' application to stay the proceedings, was entitled to defer to the Belgian bankruptcy court, the key question was whether it was obliged to do so, or whether it ought to have exercised its discretion to do so.

The Court clarified and accepted as accurate the following two propositions: (1) that, by Canadian law, the holder of a valid maritime lien is in the position of a secured creditor with priority over all other secured creditors; and (2) although the Ship is clearly subject to the Belgian bankruptcy proceedings, the implementation and recognition of foreign bankruptcy orders in Canada is not a “rubber stamping” process; a court considering an application for recognition of foreign orders must consider the interests of the litigants before it and other affected parties in Canada, including public policy as expressed through relevant legislation and the juridical advantage available to litigants in Canada. Thus, it is not the characterization of a proceeding as either “maritime” or “bankruptcy and insolvency” that is decisive. Rather, a court must balance the factors relevant to each proceeding in determining whether to give recognition to a foreign bankruptcy order.

In *Holt Cargo Systems* (the appeal from the Federal Court action), the Court held that the trial judge had properly considered the relevant factors in determining that the Federal Court was the appropriate forum to resolve Holt's claim. In *Re Antwerp Bulkcarriers*, the Court held that the Quebec Superior Court did not have the jurisdiction under the BIA to stay the *in rem* action against the Ship already subject to the process of the Federal Court.

In the result, the proceeds derived from the sale of the Ship were recovered by the secured creditors holding maritime liens under Canadian law, rather than by the Trustees in the Belgian bankruptcy.

Analysis

In *Holt Cargo Systems*, the Court, in arriving at its decision, resolved seven separate issues as follows:

1. Holt had a valid maritime lien against the Ship. Canadian law holds that a court will recognize a foreign maritime lien unless the recognition of the lien would be opposed to some domestic policy or procedure. Once the lien is recognized, priority is determined according to Canadian law. The policy of universalism was not a matter of domestic policy such as to

invalidate the lien. The Holt lien, based on a U.S. statute, was valid and ranked in priority above the mortgagee of the Ship.

2. Holt enjoyed a juridical advantage in Canada that would be in jeopardy if the Federal Court were to stay the *in rem* proceeding against the Ship. If Holt were to claim as a creditor in the Belgian bankruptcy proceedings, it would be unlikely that the Belgian bankruptcy court would recognize its maritime lien.

3. Under Canadian bankruptcy law, Holt was considered a secured creditor. Accordingly, Holt would have been entitled to realize on its security despite the bankruptcy of the Owner. In both judgments, the Court noted that this was a relevant consideration in determining whether or not to stay proceedings in deference to the Belgian bankruptcy proceedings (at pages 27-28):

I appreciate, of course, that “universalism” will not work if every jurisdiction only defers to the law of the primary bankruptcy where that law coincides precisely with the domestic law of the deferring court. The fact remains, however, that Canadian public policy, expressed through the Act, strongly supports the rights of claimants whom we would regard as secured creditors. Our law considers it in the interests of commercial activity generally that secured rights be protected. It seems to me that MacKay J. correctly regarded Holt as a “secured creditor” in bankruptcy terms, and in the exercise of his discretion under s.50 of the *Federal Court Act*, he was entirely justified in putting considerable weight on that factor.

In *Re Antwerp Bulkcarriers*, the Court made clear that though the Canadian public policy concerning the position of secured creditors in a bankruptcy is not the overriding concern in every case involving foreign bankruptcy orders and international comity, in the present case, the lower courts did not err in giving effect to it.

4. Under Canadian law, the effect of a bankruptcy is to assign all of the bankrupt’s assets to the Trustee. However, as a debtor cannot assign that which they do not have, any such assignment is subject to prior existing charges. Consequently, although the Belgian bankruptcy of the Owner gave the Trustees a valid interest in the Ship, this interest was subject to existing charges recognized under Canadian law, including those of the maritime lienholders who were then proceeding against the Ship *in rem* in the Federal Court.

5. The Trustees contended that once the Belgian bankruptcy court order was recognized by a Canadian court with bankruptcy jurisdiction pursuant to s.183(1) of the BIA and 17(6) of the *Federal Court Act*, the matter became a bankruptcy matter and the Federal Court lost jurisdiction to deal with the Ship. The Court held that although the combined effect of the above-referenced sections is to remove bankruptcy from the jurisdiction of the Federal Court, in the present case, the Federal Court was not in any way exercising jurisdiction in bankruptcy. The Federal Court, having recognized (a) the *in rem* nature of Holt’s action, (b) the secured status of Holt as a lienholder and (c) the treatment of secured creditors in Canadian bankruptcy law, the Federal Court was not jurisdictionally barred from continuing to adjudicate Holt’s action against the Ship.

In *Re Antwerp Bulkcarriers*, the Court summarized the foregoing more succinctly, stating that once properly engaged, the maritime jurisdiction of the Federal Court was not lost by the

subsequent bankruptcy of the Owner. The *in rem* proceedings thereafter were the normal course of action in maritime proceedings.

6. The Court then turned to consider whether the Federal Court ought to have exercised its discretion to stay the action on the bases of international comity and universality in international bankruptcies.

It was held that the Quebec Superior Court in bankruptcy “did not have a monopoly” in determining what level of respect and deference was to be accorded the orders of the Belgian bankruptcy court. It could do so only within the extent of its own bankruptcy jurisdiction. The Federal Court, considering Holt’s claim in relation to maritime matters, was itself entitled to determine whether to defer to the Belgian bankruptcy court “having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.”

With respect to the “universalist approach”, the Court stated:

There is much to be said for the proposition that primary insolvency proceedings having been instituted in Belgium, other jurisdictions where the bankrupt possessed assets should cooperate to the extent permitted by their respective laws with the Belgian courts. The need for such international cooperation in bankruptcy and insolvency has been evident for a very long time, though the ever-continuing ascendancy of multi-national enterprises and acceleration towards a global economy have made the underlying problems more acute.

After contrasting the universalist approach to international bankruptcies with the “territorialist approach”, the Court noted:

Traditionally, only some of the key components of the universalist approach have been reflected in Canadian law. While our courts generally favour a process of universal distribution and recognize a foreign trustee’s title to property, they also permit concurrent bankruptcies and protect the vested rights of what we regard as secured creditors under Canadian law.

The Court determined that Canada adheres to a “pluralist approach” to international bankruptcies “which recognizes that different jurisdictions may have a legitimate and concurrent interest in the conduct of an international bankruptcy, and that the interests asserted in Canadian courts may, but not necessarily must, be subordinated in a particular case to a foreign bankruptcy regime.” In such a system, the ultimate goal is coordination rather than subordination and deference will only be accorded after “due consideration of all the relevant circumstances”.

In considering whether Canadian courts ought to move toward a more universalist approach, the Court considered the effect of the recently enacted Part XIII of the BIA. While noting that the objective of Part XIII was to facilitate the coordination of foreign and domestic insolvency proceedings, the Court determined that Parliament “anticipated that in certain cases a territorial approach would be acceptable.” Evidence of this was found in the facts that (a) the provisions anticipated concurrent proceedings, (b) in concurrent proceedings, a domestic trustee’s authority was limited to assets in Canada, (c) a Canadian court is not compelled to enforce an order of a foreign court, and (d) a foreign stay of proceedings does not apply in Canada unless the stay is the result of proceedings taken in Canada.

Overall, the Court held that the pragmatism of the pluralist approach recommended itself. The following paragraphs provide a good summary of the Court's views as to when a Canadian court should exercise its discretion to stay proceedings in recognition of a foreign bankruptcy order:

Where a stay is sought of Canadian proceedings in deference to a foreign bankruptcy court, the Canadian court before which the stay application is made (in this case the Federal Court) ought to be mindful of the difficulties confronting the bankruptcy trustees in the fulfilment of their public mandate to bring order out of financial disorder and the desirability of maximizing the size of the bankrupt estate. These objectives are furthered by minimizing the multiplicity of proceedings, and the attendant costs, and the possibility of inconsistent decisions in relation to the same claims or assets.

Nevertheless, courts must have regard to the need to do justice to the particular litigants who come before them as well as to the public interest in the efficient administration of bankrupt estates. It would be inappropriate to elevate any one consideration to a controlling position in the exercise of a bankruptcy court's discretion to dismiss a petition under s. 43(7) or to stay proceedings under Part XIII of the Act or in the Federal Court's decisions to stay proceedings under s. 50 of the *Federal Court Act*. Discretion should not be thus predetermined. The desirability of international coordination is an important consideration. In some cases, it may be the controlling consideration. The courts nevertheless have to exercise their discretion to stay or not to stay domestic proceedings according to all of the relevant facts of a particular case.

7. In the result, as the Federal Court had jurisdiction over the Ship action and was not obliged to stay the action on the basis of international comity and universality principles, the decision as to whether or not to stay the proceedings was entirely within the Federal Court's discretion. The Court held that such a determination was to be made based on the principle set out in *Amchem Products Inc. v. B.C. (W.C.B.)*, [1993] 1 S.C.R. 897 that "the existence of a more appropriate forum must be clearly established to displace the forum selected by the plaintiff."

Factors to be considered include public policy, juridical advantage, where the parties carry on their business, the convenience and expense of litigating in each proposed forum and the discouragement of forum shopping. The Court held that the Federal Court trial judge had adequately considered these factors and properly determined to retain jurisdiction and allow the action to proceed.

As alluded to above, in *Re Antwerp Bulkcarriers*, the Court also addressed the issue of domestic comity. The Court was very clear in stating that it was inappropriate for a court to purport to deal with an asset already subject to an order of another court of competent jurisdiction. The Ship had been disposed of by order of the Federal Court and, as such, the Quebec bankruptcy court had no jurisdiction to make a contrary order.

With respect to the Quebec bankruptcy court's order concerning the distribution of the proceeds from the sale of the Ship to the Trustees, the Court held that this order similarly contravened the principles of domestic comity. The Federal Court, exercising valid jurisdiction, had already ordered that the sale proceeds be distributed to the secured creditors. While the Quebec bankruptcy court was correct in making its orders subject to the rights of secured creditors, it erred in purporting to deny the secured creditors the realization of their security.

The Court restated the *Morguard* principle that “the considerations which underly rules of comity apply with even greater force between the units of a federal state than they do internationally”.

In simple summary on this point, the Court noted:

Had the bankruptcy occurred in Canada instead of Belgium on April 5, 1996, the Quebec Superior Court would have had no authority to command the Federal Court to stay the proper discharge of its maritime law jurisdiction. The Quebec Superior Court did not acquire by its endorsement of international comity a jurisdiction it did not otherwise have.

(b) *Provida Treuhand SA v. Sport Dinaco Inc.* (2000) Q.J. No. 621 (Q.L.) (S.C.)

Facts

Sport Dinaco Inc. (“Dinaco”), a Quebec company, was the exclusive Canadian distributor of Raichle ski boots and accessories. On June 14, 1995, Raichle and its parent company filed for bankruptcy under Swiss law.

On March 23, 1999, Raichle’s Trustee served on Dinaco an action before the Superior Court of Quebec seeking to recover a loan of \$2 million made in March 1991. Six days later, Dinaco instituted a separate action against Raichle in the Superior Court of Quebec claiming damages of approximately \$2.6 million for breach of the distribution agreement, specifically, failing to deliver Raichle boots to Dinaco. The Trustee brought a motion to the Court seeking to have Dinaco’s claim dismissed or stayed because, *inter alia*:

- (a) it was a claim provable in bankruptcy and, therefore, could only be commenced after a proof of claim had been filed with the Trustee, and, further, that the Trustee had already refused the claim; and
- (b) as bankruptcy proceedings had already been commenced in Switzerland, in order to avoid multiplicity of proceedings, the Quebec Superior Court should stay the proceedings in Quebec.

At the hearing of the motion, both parties provided expert evidence concerning Swiss bankruptcy law and the likely treatment of Dinaco’s claim thereunder. The Court concluded that as Dinaco’s action sought damages accruing after the bankruptcy of Raichle (and not, as contended by the Trustee, as a consequence of the bankruptcy of Raichle), the action was not a claim provable in bankruptcy under Swiss law. Therefore, according to Swiss law, the claim could be “enforced by way of ordinary legal action...”

With respect to the Trustee’s arguments concerning multiplicity of proceedings, the Court found it inappropriate to order a stay pursuant to the provision in the BIA which permitted it to do so, as it concluded that section was intended to “facilitate, approve or implement arrangements that will result in a coordination of proceedings under the [BIA] with any foreign proceeding”. Since the Trustee had not commenced insolvency proceedings in Quebec under the BIA, this section was not relevant. The Court also interpreted the foreign stay enforcement provisions under the BIA to apply only to claims provable in bankruptcy against a foreign bankrupt and, as discussed

previously, Dinaco's claim was found not to be a claim provable in bankruptcy. There was, accordingly, no multiplicity of proceedings, and the claim was allowed to proceed in Quebec.

(c) *360networks inc.(Re)* (2001) B.C.S.C.

The tensions that can arise between courts in international insolvencies and strategic considerations as to comity between courts was recently illustrated in a series of Canadian court rulings involving the global fibre optic network supplier 360networks inc. ("360"), its indirect Brazilian subsidiary and creditors in Brazil.

Facts

As its name suggests, 360 was embarked upon a global undertaking to construct and purchase a worldwide fiber optic network, a component of which was being acquired through its indirect subsidiary 360 Brazil to whom 360 made substantial intercompany loans. 360 Brazil entered into contracts with Brazilian suppliers for the supply and maintenance of a component of the proposed network in Brazil and Argentina.

360 encountered financial difficulty in the spring of 2001 and on June 28, 2001 it filed for bankruptcy protection under the CCAA in Canada together with a number of related companies. At the same time, it initiated concurrent Chapter 11 proceedings with a number of differing related companies in the U.S. (connected through a Cross Border Insolvency Protocol) and commenced liquidation proceedings for a number of its subsidiaries in Europe and Asia. However, 360 Brazil did not take the benefit of any insolvency proceedings in any country.

An important asset of 360 at the time of its Canadian filing was a loan receivable due from 360 Brazil. 360 Brazil had sufficient liquid funds to repay that receivable and had contracted to do so, but Brazilian currency restrictions prevented the funds from being repatriated immediately. After the insolvency filings in Canada and the U.S., 360 Brazil entered into a financial derivative contract which provided for the return of some \$20,000,000 on August 17, 2001 by way of interbank transfers from Brazilian banks to a Canadian chartered bank.

As 360's financial difficulties came to light, the Brazilian suppliers of 360 Brazil became highly concerned about the prospect of default and in early August of 2001 they initiated a series of arbitration proceedings in New York and debt collection proceedings in Brazil. Through the ex parte assistance of the Brazilian Courts, one creditor (the "Creditor") obtained an injunction in Brazil on August 15, 2001 restraining 360 Brazil from repatriating the loan receivable due to 360 as ostensible security for the debt claims of the domestic creditor.

Unfortunately for the Creditor, the Brazilian court's injunction order was not served on 360 Brazil until 13 minutes after the necessary key strokes were entered at the Central Bank of Brazil to send the money irretrievably on its way to Canada. On hearing this, the Brazilian courts issued a series of Orders compelling 360 Brazil to attempt to retrieve the funds but 360 Brazil was unable to do so, as the funds were by that time in the possession of 360's chartered bank in Toronto, which in the face of a demand by 360 to pay them over to the account of 360, and a corresponding demand from 360 Brazil to return them to Brazil, sought an interpleader order in 360's CCAA proceeding and was permitted to pay the funds into Court in Canada whereby they became subject to the control of the Canadian Court until entitlement to them could be

determined. The Creditor was given notice of the Canadian entitlement proceeding and appeared in Canada to contest 360's entitlement and on application attempted to cause the funds to be returned to Brazil.

Prior to the determination of entitlement to the fund in Canada, the Brazilian court on September 28, 2001 reconsidered its repatriation order and rescinded it on principles of proportionality that the remedy was in excess of the claims that appeared capable of being made out.

On October 16, 2001 the Canadian Court heard the competing claims as to entitlement and held that as 360 was the only party that had a property interest in the funds it would cause them to be paid to 360. The Court noted that because the only claim of the Creditor was through the enforcement of unliquidated claims in damages against 360 Brazil, it was insufficient under the British Columbia interpleader rule to establish entitlement for the Creditor, as it was not a property interest. The Canadian Court refused the Creditor's request to have the Canadian Court decline jurisdiction over the fund; it clearly felt that it had jurisdiction to make the order sought to give the money to 360. The Canadian Court also rejected allegations of fraud or fraudulent conveyance on the basis that there was insufficient evidence of such actions to cause the money to be held for the ultimate benefit of a claim which had still to be made out by the Creditor. In the absence of foreign bankruptcy proceedings involving 360 Brazil and in the absence of a breach of the Brazilian repatriation order (which had been set aside on September 28th) the money was ordered to be given to 360.³

That, however, was not the end of the efforts of the Creditor in the Brazilian courts. On October 17th, 2001 a Brazilian appellate court set aside the September 28 order cancelling the repatriation order and reinstated the obligation of 360 Brazil to repatriate the funds. The Creditor sought in Canada and obtained a rehearing of its application of October 16, 2001 on the basis of this change of circumstances.

Of significant importance in the entire process is the fact that the Brazilian Court did not at any time seek to project its jurisdiction nor did it request the aid and assistance of the Canadian Court to give effect to its injunctions.

On October 25, 2001 the Canadian Court reconsidered its prior ruling and again affirmed its original order, notwithstanding the reinstatement of the repatriation order. In this ruling the Canadian Court more squarely dealt with the comity issue and held that it was acting in comity and with respect to the Brazilian Orders, but those orders did not purport to act in rem as against the fund itself, nor did the orders seek the aid and assistance of the Canadian Court. The Canadian Court ruled that it had jurisdiction and the right to determine a property interest in the fund and as no action had been commenced in Brazil in respect of entitlement to the fund, the Canadian Court was free to make a determination and by reason of the fact that the Creditor had not yet established any proprietary right, the motion of the Creditor was again rejected.⁴

³ *360networks Inc (Re)* (2001), 29 C.B.R. (4th) 287 (B.C.S.C.)

⁴ *360networks Inc (Re)* (2001), 29 C.B.R. (4th) 296 (B.C.S.C.)

The Creditor obtained an expedited appeal to the British Columbia Court of Appeal which resulted in a dismissal of the Creditor's appeal⁵ on the single grounds that because the interpleader rule under which the monies came to the court was limited to determining property rights, and as the Creditor could not establish a property right, there was no error. The Appellate court refused to allow the Creditor to create an issue around the validity of the transfer from the subsidiary to the parent, nor would it permit allegations of fraudulent conveyance to be used to give rise to a trial on that issue, or give in effect pre judgment attachment remedies by suspending release of the funds until the Creditor could perfect its remedies. As neither 360 Brazil nor any insolvency representative for 360 Brazil asserted an interest in the fund, the Appeal Court felt that the Creditor was merely using the process as a means to enforce the injunction which as a matter of comity and deference the court was not obligated or prepared to do.

Analysis

On a narrow view the Creditor failed to succeed due to the fact that the funds came into court through an interpleader application which allowed a disposition of funds only to persons who could claim proprietary rights to them and because the Canadian Court would not permit continued prejudgment attachment of funds for what was in essence a damage claim.

The limiting factor in the Brazilian Orders from a comity perspective was that the Orders were addressed only to 360 Brazil to compel that company to take steps to recover the funds. Although it appears that the Brazilian Courts were prepared to make wide ranging orders, they did not purport to assert jurisdiction over 360 outside of Brazil notwithstanding its apparent connections to the Brazilian jurisdiction through its indirect ownership of its Brazilian subsidiary and the fact that it made loans into Brazil and was the beneficiary of a derivative contract made in Brazil. The Brazilian Courts may have rightly recognized that they lacked jurisdiction over 360. It is not clear whether the Brazilian Courts were cognizant of the stay of proceedings in effect under Canadian and US law.

The Creditor was also limited by the absence of any formal involuntary insolvency process in Brazil which, for reasons not clear, were never initiated in Brazil by the Creditor or any other party, notwithstanding the apparent insolvent status of the Brazilian subsidiary. Accordingly, there was no basis to properly characterize the payment of funds from the subsidiary as a fraudulent preference or conveyance.

In any event, the Brazilian Orders were not considered by the Canadian Court to be direct claims to the funds themselves. Whether as a matter of Brazilian law such an Order could have been made is likewise not clear, but had it been construed as such the deference issues faced by the Canadian Court would have been much greater.

3. A RECENT CROSS-BORDER SUCCESS: PSINET LIMITED

Background

⁵ *360networks Inc (Re)* (2001), 29 C.B.R. (4th) 300 (B.C.C.A.)

PSINet Inc. (“Inc”), a U.S. corporation, was a publicly traded provider of internet and related services to businesses in the U.S. and elsewhere in the world. At the end of 2000, the PSINet group’s total indebtedness was approximately U.S. \$3.7 billion. Approximately \$2.8 billion of that amount was owed to senior noteholders (the “Senior Notes”). Inc had and continued to suffer enormous operating losses.

On June 1, 2001, Inc and almost all of its U.S. subsidiaries filed voluntary petitions with the U.S. Bankruptcy Court, Southern District of New York, pursuant to the U.S. Bankruptcy Code.

PSINet Limited (“Limited”) was the principal Canadian subsidiary of the PSINet group and was responsible for the development of the Canadian portion of the PSINet group’s international network. The Canadian network was linked to and integrated with the entire PSINet network. Limited was managed as part of the PSINet group from Troy, New York by PSINetworks Company, a U.S. company. While most of the assets relating to PSINet’s business were owned by Limited (or other Canadian members of the PSINet group) the ownership of the Canadian and other parts of the PSINet business was not nicely divided on national lines. Limited had assets in the U.S. As well, portions of the assets of the Canadian business were owned by PSINetworks Company, one of the Chapter 11 debtors. Nonetheless there was a significant segregation of ownership between the Canadian businesses and the U.S. businesses.

In addition to this rough division of assets on a national basis there were significant differences in the creditors of Inc and Limited. Neither Limited nor any of the other Canadian members of the PSINet group had guaranteed or were otherwise directly liable for Inc’s obligations in respect of the Senior Notes. Limited was indebted to Inc on a secured basis in the amount of approximately \$300 million.⁶ Limited also had obligations to Canadian creditors. Generally, there was no commonality of claims between Inc and Limited.

In these circumstances⁷, Limited and three other Canadian members of the PSINet group applied for relief under the CCAA through plenary proceedings designed to be co-ordinated with Inc’s Chapter 11 proceedings. At the same time, Inc and the other U.S. debtors sought and obtained relief under section 18.6 of the CCAA, which permits a Canadian Court to grant relief similar to that available under section 304 of the U.S. Bankruptcy Code.

The Sale Process

⁶ At the outset of Canadian proceedings, the indebtedness of Limited to Inc was thought to be unsecured. However, after the sale of the Canadian assets and during the course of preparing a plan to put to the Canadian creditors it was discovered that Limited had granted security to Inc upon all of Limited’s property. The security interests granted by Limited to Inc had been the subject of registrations in favour of Inc under the Ontario Personal Property Security Act. Those registrations lapsed before the Canadian filing and the existence of the security agreement from Limited in favour of Inc forgotten. When this security was discovered Inc moved in the Canadian CCAA proceedings to lift the stay of proceedings (a stay that expressly prohibited the registration of financing statements) that had been imposed by the court at Limited’s request. The application succeeded and an appeal by certain of Limited’s creditors failed. Before Limited presented a plan to its creditors Inc was restored to its position as a secured creditor. There were very few competing secured claims. Doubtless, if the existence of this security had not been forgotten, the proceedings would have been very different.

⁷ Anecdotally, it is understood that an initial approach was made seeking to avoid a plenary Canadian filing. This apparently did not find favour with the Canadian Court and a full filing was then made.

The sale of the companies' businesses had been investigated and purchasers sought for some time before the filings. Early in the proceedings the separate sale of the Canadian assets was pursued.

Limited and the other Canadian applicants along with one of the U.S. Debtors entered into an agreement with Telus for the sale of PSINet's Canadian business. On June 19, 2001 and June 28, 2001, the Ontario Court authorized Limited and the other Canadian applicants to enter into an agreement with Telus Corporation for the sale their assets. On June 28, 2001 the U.S. Bankruptcy Court authorized PSINetworks Company ("Networks"), one of the Chapter 11 Debtors and the owner of certain Canadian assets, to enter into the Telus Agreement as well. The orders made did not and were not intended to approve the sale to Telus. Any sale approval was to be dealt with in the future. The purpose of these orders was to authorize the PSINet parties to enter into the Telus Agreement as part of the process for marketing the PSINet Canadian assets.

The Telus agreement contained bidding procedures that made the sale to Telus subject to being trumped by competing bids. The Telus Agreement therefore became a stalking horse for other bidders. If other qualified bidders could be identified then an auction process would ensue. In light of the possibility that Telus might not be the successful purchaser, the Telus Agreement provided for the payment to it of a \$1.5 million break-up fee.

There were at least four relatively novel aspects to the Telus arrangement. First, the sale of all or substantially all of a debtor's assets before the presentation of a plan was relatively unusual. The approval of that course of action is obviously implicit in the court's permission given to the Canadian debtors to enter into the agreement. Second, the use of a stalking horse bid in insolvency proceedings of any kind in Canada is very unusual. Third, the approval of the payment of a significant or any break-up fee is virtually unheard of in Canadian insolvency proceedings. Fourth, the Canadian courts have shied away from auctions on the basis that they may have a negative effect on the "integrity of the sale process", watchwords in receivership and other insolvency sales procedures.

None of these issues caused the Canadian court any concern. On the motion to authorize the Canadian debtors to enter into the Telus Agreement Justice Farley made the following endorsement:

"I specifically note that this arrangement with Telus is designed to be a transparent stalking horse situation with the object of maximizing value; in these circumstances a break up fee is appropriate, if reasonable, and I find that the amount is reasonable. As it is contemplated that there will be [an] "auction" as opposed to the more usual process in Canada, counsel will ensure that the principles of Soundair are carefully scrutinized in developing the marketing and following plans and that this departure from the norm is appropriately highlighted."

This is an example of a significant cross-border effect, albeit tempered by Justice Farley's reference to the Soundair decision, a decision of the Ontario Court of Appeal concerning the principles to be applied by a court on an application for approval of an agreement of purchase and sale by a court appointed receiver in Canada.

Following the approval of the bidding procedure, marketing efforts in respect of the Canadian assets continued. However, no better offers than that represented by the Telus Agreement were received. Accordingly there was no auction.

The Protocol

On July 10, 2001, about six weeks after the initial applications for relief and after the Canadian debtors were authorized to enter into the Telus Agreement, Justice Farley, the judge seized of the Canadian proceedings, made an order approving and implementing an insolvency protocol governing cross-border matters and issues (the “Protocol”). The Protocol had already been approved by the U.S. Court. The Protocol runs to eighteen pages in length. Subject to future adjustment it identified “Cross Boarder Matters” as follows:

- (a) the approval of a sale of all or a substantial part of the assets of the CCAA Debtors in accordance with bidding or other procedures established by both courts (the “Asset Sale Approval”);
- (b) the allocation as between the CCAA Debtors and the Chapter 11 Debtors of the proceeds of sale of any assets of the CCAA Debtors implemented in conjunction with the sale of any assets of the Chapter 11 Debtors (the “Allocation of Proceeds”);
- (c) the allowance, priority and valuation of inter-company claims between the Chapter 11 Debtors and the CCAA Debtors (the “Inter-Company Claims”);
- (d) the determination, priority and resolution of issues and claims in respect of personal property assets owned or leased (including the characterization of financing leases) by one of the Debtors where the assets are not physically located in the country of the Court having jurisdiction over the Debtor and the sale of such assets (the “Asset Claims”);
- (e) the determination, priority and valuation of claims and the resolution of issues in respect of contracts in which one or more of the Chapter 11 Debtors share liability with one or more of the CCAA Debtors, either as joint or primary obligors, or as guarantors or sureties, and the assignment of such contracts (the “Contract Claims”);
- (f) the determination, priority and valuation of claims and the resolution of issues in respect of indefeasible rights of use (“IRUs”) relating to fibre optics cables crossing the Canadian and American territories, and the sale or assignment of such IRUs (the “IRU Matters”); and
- (g) the approval and implementation of any reorganization plan which may involve as parties both the Chapter 11 Debtors and the CCAA Debtors or which requires a Debtor in one jurisdiction to provide financial assistance to another Debtor in the other jurisdiction by way of a guarantee, subordination or otherwise (the “Reorganization Plan”).

The Protocol also identified those Cross Border Matters that were to be the subject of joint hearings. Those matters included Asset Sale Approval; the Allocation of Proceeds as between the Chapter 11 Debtors and the CCAA Debtors; the IRU Matters, the Contracts Claims; and the Reorganization Plan. With respect to the Reorganization Plan, a joint hearing only had to be held where the debtors in both jurisdictions were parties to the Reorganization Plan or where a

debtor in one jurisdiction was required to provide financial assistance to a debtor in another jurisdiction. Under the Protocol, the Courts could also hold joint hearings with respect to any matter relating to the conduct, administration, determination and disposition of any aspect of the proceedings. The Protocol also provided that the determination, valuation and resolution of any claim or issue in accordance with the Protocol was to be recognized by the Court for the purposes of its proceedings in respect of the debtor under its jurisdiction.

The holding of mandatory joint hearings is a departure from the protocol in other Canadian and U.S. cross-border cases where joint hearings could be held, if the parties agreed, and the detailed scope of the potential hearings is also unusual. The scope and particularity of the Protocol in large measure was a function of the determination by the debtors that a sale of assets, as opposed to a debt restructuring of the Canadian debtors, was to be pursued.⁸

The Sale Approval Hearing

On September 26, 2001, a joint hearing was held by the Ontario Superior Court of Justice and the U.S. Bankruptcy Court (Southern District of New York). The Honourable Justice Farley approved a sale of assets to Telus by the CCAA Applicants in the CCAA proceedings prior to the presentation of a plan of compromise and arrangement to the creditors. Judge Gerber approved the sale of the U.S. Debtor's Canadian assets as part of the same transaction. The joint hearing took place in accordance with the Protocol. As part of the approval motion Limited sought an order vesting the purchased assets in Telus free of the claims of secured creditors.

There was no opposition to the approval of the sale to Telus or the vesting order except from one equipment financier who wanted to be paid out in full the balance of approximately \$5 million remaining on its equipment financing leases. PSINet proposed that the sale be approved with a proviso that the monies claimed by that creditor be held by the Monitor until the creditor's entitlement was determined.

The court found that the opposing creditor would not be prejudiced or otherwise disadvantaged by the arrangements proposed by PSINet. On the other hand, there would be material prejudice to the other stakeholders if the sale to Telus were not approved. The Honourable Justice Farley stated that he could see no prejudice in monetizing the claim of RBC and then having the amount and priority dealt with at a later date.

The issue of the court's jurisdiction to approve a sale prior to a plan of compromise and arrangement being presented to the creditors was also put to the court. In reliance on the decisions in *Re Dylex* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div.), *Re Canadian Red Cross Society* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.), *Re Skydome Corp.*, [1999] O.J. No. 1261 (Gen. Div.) and *Re T. Eaton Co. Ltd.* (1999), 14 C.B.R. (4th) 288 (Ont. S.C.J.), the Honourable Justice Farley clearly stated that the court has jurisdiction to approve a sale, where circumstances dictate, prior to a plan being submitted.

⁸ The evidence filed on the initial application left all possible restructuring options open. Soon thereafter the sale of the Canadian assets clearly was the preferred option.

Justice Farley, echoing Justice Blair in *Re Canadian Red Cross Society*, noted that the sale to Telus followed the four principles set out in *Royal Bank v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (C.A.) and that these principles were “equally applicable *mutatis mutandis* in a CCAA sale situation”. Those principles are:

- (i) to consider whether the receiver has made a sufficient effort to get the best price and has not acted imprudently;
- (ii) to consider the interests of the parties;
- (ii) to consider the efficacy and integrity of the process by which offers are obtained; and,
- (iv) to consider whether there has been unfairness in the working out of the process.

Concurrently, the U.S. Bankruptcy Court approved the Telus Agreement as it related to the sale by PSINetworks Company of its Canadian assets.

Thereafter the allocation of the purchase price between PSINetworks Company and the Canadian debtors had to be sorted out. This was the subject of separate but obviously related applications in the U.S. and Canadian proceedings. It resulted in the allocation of about U.S.\$7 million from the proceeds of sale to the U.S. estates.

The Restructuring Plan

Limited’s plan of arrangement was not related to the disposition of the U.S. proceedings save to the extent that co-operation was necessary to create value for stakeholders in the U.S. and Canada and, of course, to the extent that Inc was the most significant creditor of Limited. Accordingly, no joint hearing was required and the Plan put forward in Canada was approved by Limited’s creditors without significant opposition.

4. CONCLUSION

Each of the foregoing reported cases indicates a trend away from a full application of the concept of comity and universality in Canadian courts where there is any basis for concluding that Canadian interests cannot be properly protected in the foreign jurisdiction. In the 360 case, the court concluded that where the dominant jurisdiction was in Canada, a Brazilian court order seeking to recover funds for Brazilian creditors would not be recognized in Canada notwithstanding principles of comity based on a conclusion that the foreign order did not affect “proprietary” rights in the domestic jurisdiction, and on the technical basis that no competing foreign proceeding had been commenced. In *Antwerp Bulkcarriers*, the court concluded that in a situation where a secured creditor’s rights in Canada would not be recognized by the foreign jurisdiction, this was a sufficient reason to deny comity to the foreign court, even though the foreign jurisdiction was otherwise dominant. Finally, in *Provida*, the court refused to allow an *in personem* claim to be stayed in Canada on the basis of comity to the foreign jurisdiction, even though clearly dominant, because the claim had arisen subsequent to the bankruptcy proceedings and was therefore not subject to the foreign stay. All of the decisions are supportable for the

reasons outlined, but clearly it is not as easy to invoke the principles of comity in Canada to redirect issues arising in Canada to what might appear to be the appropriate foreign jurisdiction as might appear from a reading of the apparent legislative basis in Canada for doing so.

On the other hand, the *PSINet* case is a clear confirmation of the reality that cross-border problems are being resolved with the full support of the Canadian court system, and in ways which are both co-operative with foreign courts and highly inventive from a traditional Canadian perspective. That pragmatic trend will undoubtedly continue, irrespective of the means adopted by the courts or the legislatures to address the difficult philosophical questions of how and where the principles of comity should be applied in the international marketplace.