BANKRUPTCY AND INSOLVENCY

Courts use inherent jurisdiction to "fill in the gaps"

By Brett Harrison

When dealing with novel issues under the *Companies' Creditors Arrangement Act* (CCAA), courts have increasingly been relying on the use of inherent jurisdiction to "fill in the gaps in the legislation so as to give effect to the object of the CCAA."

Although this power has allowed courts to make wide-ranging and innovative orders, many see the recent use of inherent jurisdiction as significantly eroding the rights of creditors and other non-debtor parties in CCAA proceedings.

Three examples

1. *Re Consumers Packaging Inc.*: Justice James Farley made an order under the CCAA ([2001] O.J. No. 3736) approving the sale of substantially all of the assets of Consumers Packaging Inc. in circumstances where there was no plan of reorganization contemplated. Ardagh PLC, a significant creditor and a disappointed bidder, argued that using the CCAA to initiate a receiver's sale was neither permitted by law nor was it consistent with the CCAA's statutory purpose.

Ardagh cited the Alberta Court of Appeal's decision in *Royal Bank v. Fracmaster*, [2000] A.J. No. 224 in support of its argument that generally such liquidations are inconsistent with the intent of the CCAA.

It also argued that the entire structure of the CCAA is premised upon groups of stakeholders voting on a plan that compromises their debts to allow a viable restructured enterprise to continue and that inherent jurisdiction could not, and should not, be used to alter this structure.

Justice Farley rejected the argument that the court had no jurisdiction to approve the sale. He cited the lower court decision in *Fracmaster,* which supported the statements made by Justice Robert Blair in *Re Canadian Red Cross Society* that the court could approve such a sale. He also noted that the Alberta Court of Appeal, although concerned about liquidations occurring in

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the context of CCAA proceedings, acknowledged that such transactions may be appropriate where they are in the best interests of all stakeholders.

In refusing to grant leave from this decision ([2001] O.J. No. 3908), the Ontario Court of Appeal stated that Justice Farley's "decision to approve [the sale] … is consistent with previous decisions in Ontario and elsewhere that have emphasized the broad remedial purpose and flexibility of the CCAA and have approved the sale and disposition of assets during CCAA proceedings prior to a formal plan being tendered."

These sales appear to be the normal course now, under the CCAA, but it is possible that the courts may pick up on the appellant decision in *Fracmaster* to limit the use of the CCAA to liquidate a debtor's assets.

2. *Re PSINet Ltd.*: Justice James Farley approved the sale of equipment subject to financing arrangements prior to the filing of a reorganization plan, notwithstanding an objection by the lessor of the equipment, the Royal Bank. He held that there would be no prejudice in monetizing the Royal Bank's claim and having the quantum, as well as the issue as to priority, dealt with in other proceedings given that monies equal to the full amount of Royal Bank's claim were being held by the Monitor.

One argument which was not raised by the Royal Bank in *Re PSINet Ltd.*, [2002] O.J. No. 1156, but which may arise in the future, is that by converting a security interest into a monetary claim, the court is overriding the secured parties' rights under s. 62 of the *Personal Property Security Act* to take possession of the collateral upon default. In circumstances where a secured party wanted to recover the collateral (as opposed to recovering the value of the collateral), an argument could be made that it would be inappropriate for the court to use its inherent jurisdiction to approve a sale of the collateral, as it would, in effect, be overriding legislation.

3. *Re Playdium Entertainment Corp.*: Justice James Spence authorized the assignment of a contract, notwithstanding the fact that the contract could not be assigned without the counterparties' consent. In seeking to sell its assets while under the protection of the CCAA, Playdium requested that the court authorize the assignment of its contract with Famous Players to the purchaser of Playdium's assets. The contract prohibited any assignment without the consent of Famous Players, and Famous Players objected to the assignment.

'Courts are prepared to use inherent jurisdiction in CCAA proceedings to provide novel relief.'

Justice Spence stated that although an order assigning the contract could not be granted outside a CCAA proceeding, "the CCAA order affords a context in which the court has the jurisdiction to make the order." In reasons released two weeks later, Justice Spence said that the jurisdiction for this order came from both the court's inherent jurisdiction and the statutory jurisdiction provided by s. 11(4)(c) of the CCAA. He interpreted s. 11(4)(c) as prohibiting Famous Players from taking proceedings with respect to the contract in question except on, and subject to, the terms of the assignment to the purchaser. He held that if the court did not have express statutory authority to grant this relief, it had authority by way of its inherent jurisdiction to grant orders that are necessary for the fair and effective exercise of the jurisdiction given to the court by the CCAA.

These cases make it clear that courts are prepared to utilize inherent jurisdiction in CCAA proceedings to make orders that provide novel relief, even when this affects the substantive rights of some parties.

There has been some criticism that the courts have gone too far and have improperly relied upon a doctrine that was never intended to create or interfere with substantive rights. Nevertheless, there is no indication courts will shy away from using their inherent jurisdiction.

Creditors would do well to focus their efforts on arguing why the court should not be utilizing inherent jurisdiction to grant the relief requested rather than arguing that it cannot.

Brett Harrison is an associate at McMillan Binch LLP in the litigation and corporate restructuring groups. This article is based on a paper co-authored with Dan MacDonald entitled "Inherent Jurisdiction under the Companies' Creditors Arrangement Act and the Bankruptcy and Insolvency Act: Striving for Flexibility."

Policy change could lead to more bankruptcies

DEEMED YEAR-END

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bankruptcy by substantially lessening the debts they owe to the CCRA and their other creditors, through the payment structure set out in their proposal.

Since the creditors must be better off under a proposal than in bankruptcy, it has been the practice of the CCRA to accept these deemed year-ends.

The CCRA recently advised the Association of Chartered Insolvency and Restructuring Professionals that it intended to have this practice end on Dec. 31, 2002, meaning that individuals who are filing proposals will have their entire income tax liability for the year in the post-proposal period.

The Association has requested that it be allowed to make submissions on this very important matter. Norm Kondo, spokesperson for the Association, has informed the author that the CCRA has delayed the implementation date of this directive to allow for submissions from the Association.

If this policy is implemented, it will undoubtedly lead to a number of individuals, who could have previously avoided bankruptcy by having their income tax liability reduced through a proposal, becoming bankrupt. With their large tax liability still outstanding, a proposal would no longer serve an effective purpose.

Efforts were made to obtain documentation regarding this subject for this article. However, the CCRA could not provide any.

Consequences

There will be two possible results from this change by the CCRA. First, a larger number of individuals who would have been able to previously file a proposal will declare bankruptcy. Without the ability to include a deemed year-end in a proposal, individuals will continue to have the large tax liability that originally led them to attempt to file a proposal. With this liability being maintained in the post-proposal period, these individuals will not have the financial ability to compromise their debts, including their tax liability, thus necessitating an assignment in bankruptcy.

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Second, individuals who have the financial ability to delay filing a proposal will defer filing it to the tax year-end of December 31, thus allowing them to include their entire tax liability in the proposal.

It is hoped that the CCRA will seriously consider the submissions of the Association of Chartered Insolvency and Restructuring Professionals and any other interested groups or individuals who may make submissions on this point and the resulting ramifications if the policy is implemented.

Stanley J. Kershman (skershman@perlaw.ca) is the head of the Bankruptcy and Insolvency Department at the Ottawa, Canada law firm of Perley-Robertson, Hill & McDougall LLP, as well as a speaker, author, certified specialist in bankruptcy and insolvency law and Deputy Small Claims Court Judge.

His book, Credit Solutions: Kershman on Advising Secured and Unsecured Creditors, *is now in its second printing.*

Commercially reasonable

RECEIVER

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them on November 7. On November 6, TCA requested an extension. DGL refused to agree to the extension. Fearful that DGL's offer would be withdrawn, Richters accepted DGL's offer on November 7.

On November 15, TCA told Richters that it would waive the conditions.

Justice Panet concluded that Richters' decision not to extend the deadline at TCA's request was reasonable, as there was no assurance at the time that TCA would succeed in satisfying the condition.

Reasons in *Re Proposal of 230 Travel Plaza Inc.,* [2002] O.J. No. 5006, are available from FULL TEXT: **2234-027**, 14 pp.