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Join the Party!
An Overview of the Case Law on Representation Orders in Canadian Insolvency Proceedings

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ARTICLE

Join the Party! An Overview of the Case Law on Representation Orders in Canadian Insolvency Proceedings

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Introduction:

Despite the absence of codified standard procedures pertaining to the appointment by the court of creditors' representatives in proceedings under the Companies' Creditors Arrangement Act[2] ('CCAA'),[3] recent case law across Canada has established a common approach in tackling this specific question, which arises increasingly frequently in insolvency proceedings involving several stakeholders. In fact, unlike Chapter 11 of the US Bankruptcy Code, in Canada, the CCAA does not provide for the appointment of creditors' committees representing their interest during the proceedings.[4]

It is uncontested that sections 11 and 11.52 of the CCAA grant Canadian courts a wide discretion to appoint representatives on behalf of different creditors' groups in CCAA proceedings and to even order legal expenses of such representatives to be paid by the debtor's estate.[5] The court's main objective in rendering such representation orders is to facilitate the representation of a large group of creditors who are impacted by complex insolvency proceedings so that all of the group members can be represented by a single or a few representative(s) and that their rights be protected and championed by an independent legal counsel. Regarding the payment of the representatives' legal expenses by the debtor's estate, such measure will only be ordered when it is deemed essential to the success of the insolvency proceedings.

Representation Order

Factors

In the *Nortel* case,[6] which is often referred to by insolvency professionals and by the judiciary as the leading case dealing with the representation issue, Justice Morawetz confirmed that the Canadian courts in CCAA proceedings had the power under section 11 of the CCAA to appoint representatives on behalf of different stakeholder groups.[7]

In the *Canwest Publishing* case,[8] Justice Pepall referred to the *Nortel* case when listing the factors that have been considered by Canadian courts in granting the appointment of representatives in a CCAA case. These factors are the following:

'– the vulnerability and resources of the group sought to be represented;

– any benefit to the companies under CCAA protection;

– any social benefit to be derived from representation of the group;

Notes

1 The authors are members of Borden Ladner Gervais' Financial Service Group.

2 R.S.C. 1985, c. C-36, as amended.

3 The case law developed under the CCAA regarding representation orders is also applicable to a proposal made under the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3; see *Re Kitchener Frame Limited*, July 7, 2011, Justice Wilton-Siegel, unreported.

4 11 U.S.C. sections 1102(a)(1) and (2) 1978.

5 '11 Despite anything in the Bankruptcy and Insolvency Act or the Winding-up and Restructuring Act, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.'; '11.52 (1) On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of (a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties; (b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and (c) *any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act*.
(2) The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.'

6 *Nortel Networks Corp. (Re)* [Appointment of Representative Counsel]. [2009] O.J. No. 2166 (Ont. Sup. Ct. – Commercial List).

7 Ibid., para. 12.

8 [2010] ONSC 1328.

- the facilitation of the administration of the proceedings and efficiency;
- the avoidance of a multiplicity of legal retainers;
- the balance of conveniences and whether it is fair and just including to the creditors and the Estate;
- whether representative counsel has already been appointed for those who have similar interests to the group seeking representation and who is also prepared to act for the group seeking the order; and
- the position of other stakeholders and the Monitor.'[9]

With regard to the vulnerability factor, Justice Morawetz mentioned in the *Nortel* case that the moving party seeking the nomination of a representative counsel was a group composed of vulnerable creditors notably because of their limited financial resources in pursuing a claim in complex CCAA proceedings or other related insolvency proceedings.[10] This specific factor of vulnerability was also recently commented on by Justice Kasirer of the Québec's Court of Appeal in the *Hexagone* case.[11] Justice Kasirer took a broad approach to the notion of vulnerability, stating that it is a subjective factor and that 'the vulnerability of a stakeholder, as this factor is relevant to a representation and payment order, cannot be reduced to impecuniosity. Section 11 representations orders are not limited to widows and orphans; indeed stakeholders in a variety of circumstances, with different kinds of claims and resources – employees, retirees, investors, subcontractors and others – are possible beneficiaries of such an order.'[12]

As demonstrated above with regard to the vulnerability factor, each case is different and should be examined in light of its own special characteristics and facts. Justice Newbould of the Ontario Superior Court appears to share this view since he mentioned in the *Urbancorp* case[13] that the *Canwest Publishing*'s factors are to be considered by Canadian courts, but that there still 'can be no hard and fast rules governing any particular case',[14] as the appointment of a representative is an equity relief generally sought by vulnerable stakeholders in insolvency proceedings. The principle applied by Justice Newbould was more recently reinforced by Justice Riordan of the Québec's Superior Court in the *Hexagone* case[15] (confirmed in appeal[16]) when he mentioned that the *Canwest Publishing* factors are not exhaustive and that every case needs an adapted treatment and assessment as to their application.[17]

Conflict of interests among group members

In the *Nortel* case,[18] Justice Morawetz was faced with several groups of creditors, each seeking an order appointing one specific representative for each group. Said groups were comprised of various categories of the debtor's former employees, including people receiving disability and other health care plan benefits and people with claims for termination pay and severance pay.[19] In seeking the nomination of different representatives for each group, counsel for said groups identified and alleged a number of potential points of contention or conflict as between the different employee groups. Basing himself on the *commonality of interest* theory, Justice Morawetz concluded that there was no actual conflict among the employees and ordered the appointment of one representative to act on behalf of all the debtor's former employees. Justice Morawetz also noted that 'the process can be best served by having one firm put forth arguments on behalf of all employees as opposed to subdividing the employee group'.[20]

The *commonality of interest* theory was initially developed by Canadian courts when issues relating to classification of creditors at the plan of arrangement voting stage were raised.[21] Canadian courts articulated factors to be considered in the assessment of the *commonality of interest* theory, which included *inter alia* i) the consideration of the creditors' interests which should be based on the same legal entitlement creditors have against the debtor before and after a restructuring; ii) the purpose of such interests in the context of CCAA proceedings; and iii) the fact that the creditors' interests classification should avoid jeopardising viable restructuring plans.[22] This theory will therefore be used

Notes

9 Ibid., para. 21.
10 See note 6, para. 13.
11 *Bridging Finance Inc. c. Béton Brunet 2001 inc.*, 2017 QCCA 138.
12 Ibid., para. 21.
13 [2016] ONSC 5426.
14 Ibid., para. 12.
15 [2016] QCCS 6792
16 See note 11.
17 See note 15, para. 15.
18 See note 6.
19 Ibid., para. 3.
20 Ibid., para. 64.
21 *Re Stelco Inc.* 15 C.B.R. 5th 307 (Ont. C.A.), paras 21-23; *Re Canadian Airlines Corp.* (2000) 19 C.B.R. 4th 12 Alta. Q.B., para 31
22 See note 6, para. 62.

by Canadian courts should the question of conflict of interests among group members is raised.

That being said, the representation order can provide for an opt-out mechanism should a specific member of the represented group prefer not to be included in said group due to a potential conflict of interest. In such a case, the excluded member could decide to seek specific representation to assist him in protecting his rights within the CCAA proceedings, as it was ordered by Justice Newbold in the *Urbancorp* case.[23]

Funding of a representative counsel and its related charge or security on the debtor's estate

Factors

In application of section 11.52 (1)(c) of the CCAA, Canadian courts may order that a charge be placed on the debtor's estate, in order to secure the payment of financial, legal or other experts engaged by an interested person in CCAA proceedings. Such interested persons or group of persons include creditors or other stakeholders that have petitioned the Courts seeking a representation order. However, as stated by Justice Newbould in the *Urbancorp* case,[24] 'the Court must be satisfied that the security or charge is necessary for the effective participation of representative counsel in the proceedings'.[25]

In the *Canwest Publishing* case, Justice Pepall, considering this specific issue, referred to several factors that may be considered by the courts, which include:

'– the size and complexity of the businesses being restructured;

– the proposed role of the beneficiaries of the charge;

– whether there is an unwarranted duplication of roles;

– whether the quantum of the proposed charge appears to be fair and reasonable;

– the position of the secured creditors likely to be affected by the charge; and

– the position of the Monitor.'[26]

With regard to the factor of the fair and reasonable aspect of the proposed charge, Justice Newbould mentioned in the *Urbancorp* case that '[t]his issue is really whether the Urbancorp estates should fund representative counsel. I am not at all satisfied that a security or charge against the Urbancorp properties is necessary for the effective participation of purchasers in these proceedings. There is no evidence of any financial inability of the purchasers to jointly engage counsel to represent them.'[27] Therefore, it seems that the vulnerability factor discussed previously is intimately linked to the factor of the fair and reasonable aspect of a charge with regard to funding.

To this effect, in the *Hexagone* case the group seeking a representation order was exclusively comprised of subcontractors in the construction industry as opposed to individual purchasers of residential units in the *Urbancorp* case. The subcontractors, which had not alleged the specifics of their respective patrimonial circumstances,[28] were considered vulnerable and allowed funding for their representatives' counsel contrary to the representative of the purchasers of homes who lost their deposits in the *Urbancorp* case. In the *Urbancorp* case, in refusing to authorise the funding of the representative's counsel, Justice Newbould was of the opinion that 'there was no evidence that the purchasers could not together retain any law firm to represent all of them',[29] thus taking into account the capacity of the members of the group seeking a representation order to jointly retain (and pay for) proper representation. On the other hand, in appeal of Justice Riordan's order authorising the funding of the representatives' counsel, Justice Kasirer in the *Hexagone* case was of the opinion that '[i]t was not unreasonable for the judge to consider that the subcontractors' claims were vulnerable, given the cost of individual participation, as opposed to a focus on the wherewithal of each of the 140 subcontractors.' It is interesting to note how diametrically opposed the findings with regard to the vulnerability factor were in the *Urbancorp* case and in the *Hexagone* case.

Furthermore and as mentioned in the *Urbancorp* case, the proposed funding and its charge on the debtor's estate have to be fair to all stakeholders and should not be solely in the interest of one group of stakeholders:

> '[24] Estate funds should be spent for the benefit of the estates as a whole, not for the benefit of one group whose interests are contrary to the interests of the estate as a whole. If there is some equity available after all creditors of these Urbancorp entities have been paid, there are other interests entitled to share in such equity, including other Urbancorp entities

Notes

23 See note 13, paras 20 and 27.
24 Ibid.
25 Ibid., para. 14; see also the Hexagone case at note 15, paras. 48 to 53.
26 Canwest Publishing Inc., 2010 ONSC 222 (CanLII), para 54.
27 See note 13, para. 22.
28 See note 15.
29 See note 13, para. 16.

> under cross-collateralization agreements and Urbancorp Inc., represented by its Foreign Representative Mr. Gissin, which owes approx. $64 million plus interest on debentures issued in Israel and which is the shareholder of many of the Urbancorp insolvent entities.
>
> [25] Thus it is not at all clear that funding a representative of the purchasers will be for the benefit of the companies in question.'[30]

It is interesting to note that in the *Nortel* case, the moving parties also requested that the representatives' fees be supported by the debtor's estate. The monitor was of the view that the financial burden of multiple representative counsels would significantly increase the pressure on the already delicate debtor's financial position.[31] Although Justice Morawetz did not specifically address this particular argument made by the monitor in his judgment, it can be assumed that the burden to be imposed on the debtor's estate with regard to the representative fees will be considered by the courts. This was also confirmed by Justice Riordan in the *Hexagone* case,[32] where he stated that the funding and its related charge are exceptional measures that should be limited to whatever is essential to the success of a debtor's restructuring.[33]

In addition to the *Canwest Publishing*'s factors regarding the funding of representative counsel, in the *Hexagone* case Justice Riordan referred to sub-factors elaborated by Justice Gouin in the *Homburg* case[34] with regard to the particular question of the benefit for the debtor's estate of the funding of the representative fees by said debtor's estate (and its associated charge). Said sub-factors include, *inter alia*, i) the notion that the duplication of the representative's goals and tasks should be avoided, taking into consideration the role of the monitor, who is already acting in CCAA proceedings for the benefit of all stakeholders as an independent and impartial court appointed officer; ii) the fact that the participation of a representative should be constructive for the benefit of all stakeholders and shall not include the challenge of the restructuring proceedings per se; and iii) the rapid establishment of a clear scope with regard to the representative's goals and tasks, together with a determined budget which should be approved by the court only when there is a clear added value for the benefit of all stakeholders.[35]

Conclusion

As mentioned by Justice Gouin in the *Homburg* case,[36] in CCAA proceedings, it is already provided that the courts appoint a monitor who shall at all times remain independent and act impartially for the benefit of all stakeholders. Usually, in CCAA proceedings, creditors and other stakeholders turn to the monitor to address issues they might have, especially with regard to the processing of their claims. It is principally for this reason that representation orders are uncommon in Canadian CCAA proceedings, as they are only limited to cases involving large groups of stakeholders with common interests.[37]

Even if the questions surrounding representation orders are fairly novel in CCAA proceedings, Canadian courts have established guiding factors that moving parties should respect and prove, in order to be granted the appointment of a representative and the funding of its fees and disbursements by the debtor's estate. It is important to note that despite the elaboration of said factors, Canadian courts have clearly indicated that they are not exhaustive, that the representation order is an equity remedy and that each case is different and should be examined in light of its own special characteristics and facts. For these reasons, it will be interesting to follow the evolution of the case law with regard to the question of representation orders and of its funding, and more particularly, with regard to the question of the scope of the vulnerability factor applied to both the request for the appointment of a representative, as well as to the funding request of said representative's fees and disbursements by the debtor's estate.

Notes

30 Ibid., paras. 24 and 25.
31 See note 6, paras. 7-8.
32 See note 15
33 Ibid., para. 38 citing *Re Mecachrome International Inc.,* 2009 QCCS 1575, para. 77.
34 2014 QCCS 980.
35 See note 15, paras. 45 and 46.
36 See note 34.
37 See for example *Re Target Canada Co.* [2015] ONSC 303 and *Re Target Canada Co.* [2015] ONSC 1028

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