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Acceptance Remarks of the Honourable Geoffrey Morawetz

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ACCEPTANCE REMARKS OF THE HONOURABLE GEOFFREY MORAWETZ

Mr. Attorney General, distinguished judges, Dean Schapiro, faculty, alumni, current students and guests—it is a privilege to address you this evening on the occasion of having been selected as the recipient of this year’s award.

As the first non-American to be so honored, I thought it would be appropriate in my remarks to provide to an American audience some background regarding how the Canadian legal system concerns itself with bankruptcy and insolvency matters, followed by a description of how the Canadian system interacts with the U.S. bankruptcy system on cross-border matters. Finally, I will illustrate how cooperation exhibited between our two countries in this area is being recognized for its progressive developments in the context of the world-wide insolvency field.

Under the Canadian Constitution,¹ the subject of bankruptcy falls within the powers of the federal government. However, certain matters that are closely related to insolvency fall under the heading of property and civil rights which are within the purview of the ten provincial and three territorial governments.

The fundamental insolvency statutes of Canada, namely, the *Bankruptcy and Insolvency Act* (or “BIA”),² the *Companies’ Creditors Arrangement Act* (or “CCAA”),³ and the *Winding-Up and Restructuring Act* (or “WURA”),⁴ all designate a “court” to be a superior court in the various provinces and territories. In Ontario, where I am a sitting judge, the court is the Superior Court of Justice. Judges of the Superior Court receive their appointment from the Attorney General of Canada of the Federal Government. Unlike U.S. Bankruptcy judges, appointments are for a period “during your good behavior,” limited only by the retirement age of 75.

There is no separate bankruptcy court in Canada. Canadian superior courts are general jurisdiction courts. In certain commercial centres, there is an

¹ Constitution Act, 1867, 30 & 31 Vict., c. 3 (U.K.), reprinted in R.S.C. 1985, app. II, no. 5 (Can.).

² R.S.C. 1985, c. B-3.

³ *Id.* c. C-36.

⁴ *Id.* c. W-11.

informal panel of judges who will generally hear bankruptcy and insolvency matters. Efforts are made to ensure that insolvency matters are handled appropriately. However, the situation certainly varies across the country.

Our insolvency laws are based on English law. This is not unusual as it recognizes our colonial heritage and the fact that American independence did not extend north of the Great Lakes and the St. Lawrence River.

Canada's status as a British colony was not altered until 1867, with the passage of the *British North America Act* establishing the Dominion of Canada.⁵

Legislation evolved and a bankruptcy act was first passed in 1919. At that time, the *Bankruptcy Act* did not affect the rights of secured creditors. It was not until 1992, when substantial amendments were made to broaden the application of the statute, that it first affected the rights of secured creditors. At that time, the statute was renamed the *Bankruptcy and Insolvency Act*. The amendments reflected a significant policy shift. Up to that point in time, the *Bankruptcy Act* did not embrace a culture of restructuring. The statute did have provisions that enabled a debtor to formulate a proposal to its creditors, provided they were unsecured creditors. But the act only provided for a stay of proceedings as against unsecured creditors. Secured creditors were generally free to exercise their realization rights with respect to the collateral charged in their favor.

Furthermore, the act did not contain provisions which governed secured creditor realization proceedings, known as receiverships.

The 1992 amendments reflected a growing interest in restructuring and the rehabilitation of debtors, a theme to which I will return.

A second federal insolvency statute had been enacted in the Great Depression: the *Companies' Creditors Arrangement Act*, which did provide some relief for debtors as against their secured creditors. However, its use was quite restricted and it was rarely used until the mid-1980s. The statute at that time was very brief. It contained a mere 20 sections, and as it gained popularity in the 1990s, it provided great scope for judges to utilize their inherent jurisdiction to fashion solutions resulting from sparse statutory guidance. In the context of cross-border matters, the statute became affectionately known in the United States as "chapter 11 without rules."

⁵ 1867, 30 & 31 Vict., c.3 (U.K.).

A third insolvency statute, the *Winding-Up and Restructuring Act*, also plays a role in Canadian insolvency law. However, this statute is restricted in its application to banks (both domestic and foreign), trust companies, insurance companies, loan companies with borrowing powers, building societies having capital stock, incorporated trading companies doing business in Canada regardless of where they are incorporated, and corporations incorporated under federal or provincial authority whose affairs are subject to the legislative authority of Parliament.⁶ This statute is beyond the scope of my remarks this evening.

The position of secured creditors has always been recognized in our legislation. Insofar as relationships between secured creditors and debtors fall under the heading of property and civil rights, the regime under which priorities are established for secured creditors has, for the most part, been founded on provincial legislation.

Most students at Emory University in the last 50 years will hardly recognize these historic relics. However, in the days prior to the Canadian equivalent of Article 9 of the Uniform Commercial Code, insolvency concepts were very different. The fixed and floating charge debenture was for generations the fundamental security instrument. The fixed charge generally covered real estate and equipment and the floating charge covered inventory and receivables. The floating aspect of the charge would become crystallized on the event of default. Another form of security document was the chattel mortgage and a further variation was the conditional sale. Each of these security instruments had its own statute. In Ontario, registration of the fixed and floating charge debenture came under the *Corporation Securities Registration Act*.⁷ Registration of a chattel mortgage came under the aptly named *Chattel Mortgages Act*⁸ and likewise a conditional sale fell under the *Conditional Sales Act*.⁹ There was also the *Assignment of Book Debts Act*.¹⁰ Priority of security interests was not necessarily measured by registration date. Rather, it would be based on when the floating charge was crystallized or when steps were taken to notify account debtors of the assignment of book debts. The specifics behind a valid registration were numerous and detailed. Mistakes were often made and even trivial errors made by the secured creditor (or the

⁶ R.S.C. 1985, c. W-11, s. 6.

⁷ R.S.O. 1980, c. 94.

⁸ R.S.O. 1970, c. 45.

⁹ *Id.* c. 76.

¹⁰ *Id.* c. 33.

unfortunate lawyer acting on behalf of the secured creditor) would quite often result in the security being set aside and declared to be subordinate to the interests of the trustee in bankruptcy acting on behalf of unsecured creditors.

In April 1976, the Province of Ontario proclaimed the *Personal Property Security Act*¹¹ (or “PPSA”), which was based on the Article IX of the Uniform Commercial Code. The security concepts I mentioned earlier were abolished in favor of intention, attachment and perfection. The guiding words of the UCC spread northward into Canada; first to Ontario, and then to the remaining provinces, except Quebec, which has a security regime based on the *Civil Code*.

The effect of the introduction of the PPSA was revolutionary in terms of secured lending. The transition from a fixed and floating charge debenture regime to a general security agreement regime, and from a priority regime based on crystallization of the floating charge to perfection by date of registration or possession, translated into a system under which the scope of unencumbered assets was significantly diminished.

The introduction of the PPSA, based as it was on Article IX, was the first in a wave of U.S.-style legislation that spread to Canada.

The extension of the BIA to cover secured creditors followed in 1992. It was accompanied by a codification of the rights and obligations of a secured creditor. Guidelines were established for providing mandatory notice of intention to realize on collateral. The amendments gave the court a degree of control over receiverships that involved all or substantially all of the property of the debtor. It also imposed on the persons who conducted such receiverships a duty to disclose, a duty to act in good faith and a duty to account for their conduct of the receivership.

The 1992 BIA amendments also provided a debtor the ability to file a proposal under which a stay of proceedings could, in appropriate circumstances, be enforced as against secured creditors.

These changes were intended to facilitate a regime under which debtors could fashion a compromise with their creditors and, in this way, the emphasis was put on rehabilitation as opposed to the liquidation of active businesses.

¹¹ *Id.* c. P-10.

In the succeeding years, other U.S. concepts followed. Debtor-in-possession, or DIP financing, was common in the United States when it was first introduced into Canada. Originally, there was no statutory provision that expressly authorized DIP financing and parties had to rely on the court exercising its discretion to authorize DIP financing.

Ultimately, DIP financing was codified into both the BIA and the CCAA in 2009.

Other concepts that have similarly spread from the U.S. to Canada in the restructuring area include: asset sales under section 363 in advance or in the absence of a plan, stalking horse and credit bids and the acceptability of using the CCAA restructuring statute to in effect authorize the liquidation of a debtor's assets.

Another significant change to our legislation occurred in 2009 with the confirmation that equity claims would indeed be subordinate to the position of creditors.

With the statutory framework having been significantly altered to in effect foster a climate of restructuring, the traditional manner of formulating a plan of arrangement also changed. Previously, restructurings were directed at compromising debt and leaving the position of equity intact. Today, this type of reorganization is very rare. Rather, there is an accepted recognition that if a debtor is insolvent, the value of its equity is zero. On this basis, the position of old equity is by and large eliminated in most restructurings with unsecured creditors being converted from a debt position to an equity position. Obviously, there are numerous exceptions to this generalization, such as where the corporate entity is kept intact for the utilization of tax losses or where it is otherwise uncertain as to whether equity should be eliminated in its entirety.

There have been a number of benefits associated with the U.S. concepts that have spread to Canada. Most parties would conclude that the environment is now far more conducive to a restructuring as opposed to liquidation and the elimination of going concern entities.

The landscape has certainly changed over the years. The participation and objective of secured parties is neither consistent nor predictable.

Financing by bond issues has also increased. The numbers of creditors and the identity of such creditors are often unknown. What is known is that these

groups usually have the capacity to organize, on their own terms and on their own schedule in any restructuring.

We also know that the deployment of capital does not have any geographic or political boundaries. Most of the major insolvency cases in Canada have a significant relationship with the U.S. The high-yield debt traders operating out of New York are frequent participants in Canadian proceedings. The participation of these groups in Canadian proceedings has evolved over time. Creditor concerns of 15 or 20 years ago have largely been eradicated. These concerns ranged from unfamiliar statutes to unfamiliar processes. Through the statutory reforms referenced previously in these remarks, significant differences between the laws of Canada and the United States have been reduced. Although Canadian statutes are based on English common law, many of the significant amendments over the past 20 years have been made in order to adopt and follow U.S. practices.

Another area of considerable reform was the codification of the ability of a debtor, while in a CCAA restructuring, to sell off significant assets out of the ordinary course of business. Again, the impetus for these amendments came directly from the U.S. The codification of this practice should bring about more certainty in results. Again, this is viewed as desirable from the standpoint of stakeholders.

Having legislation which provides a more consistent outcome in insolvency files has also given rise to greater cooperation in the marketplace in a restructuring. Prior to these amendments, the differences between our countries were such that consideration was undoubtedly given by certain debtors as to which jurisdiction would be more appropriate to seek relief from creditors. In some cases, it would be chapter 11 and in others it would be the CCAA. The lack of certainty and perceived differences in potential outcomes contributed to an era of forum shopping. For the most part, forum shopping is no longer a dominant issue.

It is also noteworthy that not only did harmonization of the insolvency statutes play a role in reducing forum shopping, but there was also a significant development in the mid-1990s that ultimately found its way into the laws of both countries.

In 1995, the United Nations Commission on International Trade Law (“UNCITRAL”) adopted the Model Law on Cross-Border Insolvency. It is

focused on the four pillars of access, recognition, relief, and cooperation and coordination.

The objective of UNCITRAL is to create a scenario under which there is greater cooperation between countries directed towards the objective of maximizing asset value and preserving going concern enterprises in cross-border insolvencies.

UNCITRAL did not stop with the Model Law. It also has published numerous accompanying texts including the Guide to Enactment, the Judicial Perspective, and is currently working on future projects dealing with a debtor's Centre of Main Interest and Director Liabilities.

These projects take time to develop. To reach a consensus requires significant effort and compromise in some respects. However, with an overarching objective of improving the insolvency system, delegates to UNCITRAL take their roles seriously in developing these international guidelines.

What is the situation now? We are in an era where cooperation is significant. There is no doubt that the Model Law, which does not yet address the subject of corporate groups, is widely recognized as being a very useful tool. There have now been a number of occasions where a Model Law has been referenced in Canadian and U.S. decisions. The Model Law was enacted in the United States in the form of chapter 15 in 2005 and by incorporation into both the CCAA and the BIA in 2009.

It is common to have court-to-court communication protocols existing in cross-border filings between Canada and the United States. It is also common to have joint hearings held by closed circuit television between the United States Bankruptcy Court and the Ontario Superior Court of Justice. It might be a misnomer to reference these hearings as joint hearings. For the most part, they are, in fact, parallel hearings with two separate motions in two courts with submissions being carried over from one court to the other court. In this area, it is clear that courts in the U.S. and Canada are demonstrating progressive initiatives.

In addition to the work being conducted at UNCITRAL, there are other groups pursuing initiatives that are intended to improve and facilitate optimum outcomes in international insolvency filings.

INSOL International, The World Bank and UNCITRAL sponsor judicial colloquia in conjunction with INSOL conferences. These judicial colloquia are held every two years and provide an opportunity for judges who participate in insolvency matters to exchange views on the current issues of the day.

INSOL itself holds conferences on a periodic basis, the next of which will be in Miami in May 2012.

The International Insolvency Institute also holds annual meetings and is focusing a study on corporate groups in an effort to find a workable international framework.

Why is a worldwide framework necessary? As noted previously, the Model Law as developed by UNCITRAL does not address the issue of corporate groups. It provides a comprehensive roadmap as to how to administer the insolvency of a single entity. The challenge is to develop a comprehensive system, acceptable to individual states, that enables group insolvencies to be administered in a predictable and equitable manner. The issues are difficult. For example, many countries have different priority systems which take into account local issues, local laws, and local priorities. Problem areas often involve individuals, such as with employment issues, retirement, and pension issues.

The objective is to move forward with progressive legislation and policies to maximize asset value, to preserve going concern business entities and to recognize the local laws.

There is an increased respect for and recognition of foreign courts and foreign jurisdictions in this area. One can only hope that shining the spotlight on these areas will promote increased writing and publishing opportunities for the Emory Bankruptcy Developments Journal in the months and years to come.

This evening has provided me with a unique opportunity. I have tried to provide a retrospective look at the area of insolvency law in Canada and how our system has refocused its policies and accommodated both the North American and an international approach. We are dealing with a globalized economy that has significant challenges. Insolvency can be viewed in a positive light as a source for renewal of business enterprises rather than recognition of failure. The system still requires improvement and hopefully there are some in the audience tonight who will take up the challenge and contribute new ideas and possible solutions for the challenges that lie ahead.

I thank you very much for this kind honor. I always dreamed of coming to Georgia in the first week of April. In my mind, the location would always bring me about 200 miles east of Atlanta to the town of Augusta. However, it became readily apparent, upon waking up, that those dreams could never become reality. The reality is, however, that I am accepting this very prestigious award for which I am extremely grateful.

Thank you very much for your attention this evening.