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"ANCILLARY PROCEEDINGS – SHOULD THE TAIL WAG THE DOG?"

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SELECT EXAMPLES OF BROAD ANCILLARY RELIEF IN CANADIAN AND U.S. INSOLVENCY COURTS

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Overview:

The co-ordination of international insolvencies has been a challenging aspect of legal practice for many decades. Varying treatment of debtor/creditor interests between jurisdictions and the sovereignty of nations (and their courts) have demanded creative approaches from the bench and bar in order to equitably deal with the aftermath of an international business failure.

Historically, two main approaches emerged to deal with international insolvencies: 1) the territorialist approach; and 2) the universalist approach. As its name suggests, the territorialist approach emphasized the application of local laws in ancillary bankruptcy proceedings over the totality of an insolvency case. In contrast, the universalist approach generally sought to centralize proceedings in one forum, typically in the country where the debtor's primary operations were based, while permitting ancillary proceedings in other jurisdictions to effectuate the orderly administration of assets. Generally, the approaches embodied under Section 304 of Title 11 of the *United States Code* (the "Code") and Section 18.6 of the *Companies' Creditors Arrangement Act* (the "CCAA")[1] favour the universalist approach. As such, the overarching principle applied in ancillary proceedings involving interests straddling the two nations has been

[1] The full texts of Section 304 of the Code and Section 18.6 of the CCAA are set out in Schedule A.

that of harmonization and integration with the main proceedings regardless of whether Canadian or U.S. based.

In order to assist in solving numerous and unanticipated problems, lawmakers wrote both Section 304 of the Code and Section 18.6 of the CCAA fairly broadly. In other words, they were designed to provide courts with flexible frameworks in which to address many different circumstances raised in the context of international insolvencies. As a result of this approach, bench and bar alike have a great deal of latitude in fashioning relief in both Canadian and U.S. based ancillary proceedings. Select examples of the breadth of relief available in North American ancillary proceedings are set out below.

Jurisdictional Predicates and Venue:

1. Section 304 of the Code

Jurisdiction

In order to seek relief in an ancillary proceeding under Section 304 of the Code, there are two necessary jurisdictional predicates: 1) there must be a "foreign proceeding" pending; and 2) the party seeking Section 304 relief must be a "foreign representative." Under the Code, a "foreign proceeding" is a "proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension or discharge, or effecting a reorganization." 11 U.S.C. § 101(23). A "foreign representative" is a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding." 11 U.S.C. § 101(24).

Besides those two jurisdictional predicates, several courts have delineated other predicates necessary to bring ancillary proceedings under Section 304. For instance, in early cases, several bankruptcy courts held that in order to seek Section 304 relief, the insolvent party had to meet the Section 101(13)[2] definition of a "debtor," as well as the eligibility requirements

[2] "'debtor' means person or municipality concerning which a case under this title has been commenced." 11 U.S.C. § 101(13).

of Section 109(a)[3]. The Eleventh Circuit Court of Appeals appears to have clarified this issue in holding that the foreign party need not qualify as a "debtor" under the Code, but need only qualify as a "debtor" under the laws of the country of the main plenary proceedings. *In re Georg*, 844 F.2d 1562 (11th Cir. 1988).

In addition, some judicial commentary has indicated a requirement that the district hosting the ancillary proceeding needs *in rem* jurisdiction over the property involved. Paul Lee, *Ancillary Proceedings Under Section 304 and Proposed Chapter 15 of the Bankruptcy Code,* 76 Am.Bankr.L.J. 115, 134-135 (Spring 2002). However, the D.C. Circuit Court of Appeals, in *Haarhuis v. Kunnan Enterprises, Ltd.*, determined that presence of the property in the district was a venue requirement and not jurisdictional. 177 F.3d 1007 (D.C. Cir. 1999). This decision remains the apparent "better view", thus eliminating any hard and fast rule requiring *in rem* jurisdiction.

Accordingly, as the law currently stands, the primary jurisdictional predicates to bringing an application under Section 304 of the Code are: 1) a foreign proceeding; and 2) a foreign representative.

Venue

Selecting the appropriate venue for a Section 304 ancillary proceeding can be an intriguing challenge in coordinating international insolvencies. The venue provisions under the Code differ depending on what relief is sought. Consequently, multiple Section 304 proceedings in multiple venues may be required to effectuate different forms of relief. For example, proper venue for an action seeking injunctive relief generally lies in the district where the proceeding against the property is pending. In contrast, venue of an action for turnover of property generally lies where the property is located. Finally, other forms of relief must be sought in the venue where the principal place of business of the debtor is located, or where the majority of the debtor's assets are located. *See* 28 U.S.C. § 1410(a)-(c). Consequently, if a foreign representative is seeking more than one form of relief under Section 304 of the Code, it is entirely possible that they may have to file multiple ancillary proceedings in multiple venues.

[3] "Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title." 11 U.S.C. § 109(a).

2. Section 18.6 of the CCAA

Jurisdiction

Subsections 18.6(2), (3) and (4) of the CCAA, together with the doctrine of inherent jurisdiction, provide courts supervising the CCAA with broad discretion in recognizing foreign insolvency proceedings and granting ancillary relief in connection therewith. In particular, subsections 18.6(2), (3) and(4) provide as follows:

> **18.6(2)** The court may, in respect of a debtor company, make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under this Act with any foreign proceeding.
>
> **18.6(3)** An order of the court under this section may be made on such terms and conditions as the court considers appropriate in the circumstances.
>
> **18.6(4)** Nothing in this section prevents the court, on the application of a foreign representative or any other interested person, from applying such legal or equitable rules governing the recognition of foreign insolvency orders and assistance to foreign representatives as are not inconsistent with the provisions of this Act.

Some commentators have suggested that the language in subsection 18.6(2) of the CCAA limits the scope of jurisdiction of a CCAA court in ancillary proceedings to making orders in respect of a "debtor company" and that the definition of debtor company under the CCAA must be met (which essentially means insolvent or formally bankrupt) before a CCAA court has jurisdiction to make an order in the nature of ancillary relief. However, in *Re Babcock & Wilcox Canada*[4], the Ontario Superior Court of Justice determined that it was sufficient for a "foreign representative" to bring an application pursuant to subsection 18.6(4) of the CCAA in order to invoke the court's jurisdiction and obtain such assistance in an ancillary proceeding as the court thinks fit so long as it is not inconsistent with the provisions of the CCAA. The decision was made notwithstanding that the company in question was not insolvent. A "foreign representative" is defined under the CCAA as meaning "a person, other than a debtor, holding office under the law of a jurisdiction outside Canada who, ... is assigned … functions in connection with a foreign proceeding that are similar to those performed by a trustee in bankruptcy, liquidator or other administrator appointed by the court."

[4] 18 CBR (4) 157 (Ont. S.C.J.) and more fully discussed in the accompanying paper "U.S.-Canadian Cross-Border Insolvencies – A Survey of Recent Ancillary Proceedings", James H. M. Sprayregen, P.C., Shirley S. Cho, Alexandra S. Kelly, Canadian-American Symposium on Cross-Border Insolvency Law, Toronto, Ontario, February ll, 2005 (the "Sprayregen Paper").

Accordingly, once the prerequisites relating to a "debtor company" or a "foreign representative" are met, CCAA courts will consider whether it is appropriate, practicable or necessary to the co-ordination of an international insolvency and to the maximization of the value of the debtor's business for the benefit of creditors (wherever located) that a foreign Court exercise principal control over the insolvency. Indeed, Canadian courts have done so outside of a formal application under Section 18.6 of the CCAA on the basis of the principle of comity alone. As noted by the Alberta Court of Queen's Bench in *Roberts v. Picture Butte Municipal Hospital*, [1998] A.J. 817 at paras. 20 & 31

> Comity and cooperation are increasingly important in the bankruptcy context. As internationalizaton increases, more parties have assets and carry on activities in several jurisdictions. Without some co-ordination there would be multiple proceedings, inconsistent judgments and general uncertainty.
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> …
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> In the circumstances of this case, the U.S. Bankruptcy Court has apparently decided that fairness among creditors is achieved without having complete equality across all classes of creditors….I find that common sense dictates that these matters would be best dealt with by one Court, and in the interest of promoting international comity it seems the forum for this case is in the U.S. Bankruptcy Court.

In *Re Matlack Inc.*, 2001 CarswellOnt 1830 (S.C.J.), a formal Section 18.6 application, the Court stated at para. 10 that:

> A stay in Canada would promote a stable atmosphere with a view to the reorganization of Matlack and its affiliates while allowing creditors, *wherever situate*, to be treated as equally as possible. The stay would also assist with respect to claimants in Canada attempting to seize assets so as to get a leg-up on the other creditors. [emphasis in original]

In the context of a Section 18.6 application, a CCAA court will also consider the principles of comity to deal effectively with international insolvencies in a harmonized and efficient manner. As stated in *Matlack* at paras. 3 & 8:

> The objective of such co-ordination is to ensure that creditors are treated as equally and fairly as possible, wherever they are located. Harmonization of proceedings in the U.S. and Canada will create the most stable conditions under which a successful reorganization can be achieved and will allow for judicial supervision of all of [the debtor's] assets and enterprise throughout the two jurisdictions.
>
> Where a cross-border insolvency proceeding is most closely connected to one jurisdiction, it is appropriate for the court in that jurisdiction to exercise principal control over the insolvency process in light of the principles of comity and in order to avoid a multiplicity of proceedings.

…

Venue

There is no specific guidance contained in Section 18.6 of the CCAA concerning where and to which court applications may be made for ancillary relief. For that, reference should be had to subsection 9(1) of the CCAA which provides:

> Any application under this Act may be made to the court that has jurisdiction in the province within which the head office or chief place of business of the company is situated or, if the company has no place of business in Canada, in any province within which any assets of the company are situated.

Accordingly, it would appear that in the context of a foreign representative's application or an application by a debtor company which does not have a head office or a chief place of business in Canada, application may be made in respect of Section 18.6 ancillary relief in any province in which any assets of the debtor company are located. This suggests that there may need to be assets located in Canada, as opposed to mere creditors, before a Canadian court would entertain a request for relief under Section 18.6 in order to, for example, bind Canadian creditors. In the event no assets are located or can be "found" in Canada but it is desirable that Canadian creditors be bound by the outcome of a plan, it may well be that the approach of relying upon the principles of comity alone as was done in *Roberts v. Picture Butte Municipal Hospital* would have to be pursued.

In *Re Androscoggin Energy LLC*[5], the Ontario Superior Court of Justice granted relief pursuant to Section 18.6 of the CCAA in respect of a US based applicant subject to a Chapter 11 case who had entered into contracts for the supply of gas in Canada. Although the contracts were subject to the law of Alberta, the gas and other purchased products were flowing through trans-national pipelines from day to day, including pipelines located in the Province of Ontario.

Breadth of Relief:

As Section 304 of the Code is structured, it specifically provides courts with the power to grant injunctive relief and to order the turnover of property. Congress then drafted a third "catch-all" provision which broadly allows courts to fashion all "other appropriate relief." Under this third provision, courts are given tremendous latitude in providing remedies in ancillary

[5] Unreported, Ont. S.C.J., January 26, 2005.

proceedings. The broad discretion captured in subsection 18.6(3) of the CCAA and reliance on inherent equitable jurisdiction are equally powerful aspects to fashion appropriate remedies in ancillary proceedings. For example, the Court in *Babcock & Wilcox Canada* stated "…once it has been established that there is a foreign proceeding…then this Court is given broad powers and wide latitude, all of which is consistent with the general judicial analysis of the CCAA overall, to make any order it thinks appropriate in the circumstances."

The breadth of relief being sought and granted in ancillary proceedings continues to expand as necessary to permit appropriate solutions to be implemented in international insolvencies. We highlight below selected aspects of the breadth of the relief being granted under Section 304 of the Code and Section 18.6 of the CCAA.

1. Discovery

One of the practical consequences of filing a proceeding under Section 304 of the Code is to effectively engage in "discovery" without actually pursuing litigation or filing a plenary bankruptcy proceeding. The turnover provisions of Section 304 can be used to obtain information without submitting a creditor to the restrictions inherent in the Federal Rules of Civil Procedure's discovery provisions. Consequently, a foreign representative may obtain the information necessary to validate or pursue claims against the debtor, or others, through Section 304.

The power to order turnover of property to foreign representatives derives from the language of Section 304(b)(2)[6] of the Code which specifically permits the U.S. Court to order turnover of property. Any such turnover will, however, be subject to the limitations courts have placed on turnover including circumstances in which there is a dispute over the ownership or property.

In *In re Gee,* the United States Bankruptcy Court for the Southern District of New York granted relief under Section 304 of the Code, allowing the foreign liquidator of a defunct Cayman Islands reinsurance company to engage in pre-suit discovery, thereby locating the debtor's assets. 53 B.R. 891, 904 (Bankr. S.DN.Y. 1985). The Court ordered turnover of the

[6] Section 304(b)(2) of the Code states as follows:
(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may . . .
(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative

debtors' books and records to a foreign representative. *Id.* The Court emphasized that such action was appropriate to expedite the administration of the estate, and that the relief would not prejudice creditors, even though no bankruptcy case was filed in the U.S.

We are unaware of similar relief having been granted by CCAA courts in Section 18.6 proceedings. However, we see no statutory impediment to granting a foreign representative access to books and records located in Canada in conjunction with the estate's administration. CCAA courts have not typically made orders permitting examinations of persons under oath, perhaps because they have not yet been asked in appropriate circumstances.

2. Injunctions

Ordinarily, a petition for relief under Section 304 of the Code will be accompanied by a request for a limited preliminary injunction, generally known as a temporary restraining order ("TRO"). Often these requests will be broadly worded to obtain as much relief as possible. If the court grants these broad requests, the TRO (and any subsequent injunction) may effectively enjoin any action against the debtor's property in the United States. In other words, while not enjoying the protection of the automatic stay in a plenary case under Title 11, foreign representatives may creatively draft requests for injunctive relief under Section 304 of the Code to either protect specific property or to have the same effect as the automatic stay.

Section 304(b)(1)[7] provides the court with the basic power to enjoin commencement or continuation of certain proceedings against a debtor. The power to enjoin proceedings may be used either (a) to address specific pieces of litigation or (b) to effect relief similar to the automatic stay under Title 11 of the Code. An example of where specific litigation has been stayed occurred in *In re Rubin*, where the Court held that an order made pursuant to Section 304 "may enjoin commencement or continuation of an action against the foreign debtor with respect to property involved in the foreign proceeding." *In re Rubin*, 160 B.R. 269, 274 (Bankr.S.D.N.Y. 1993). In *In re Blackwell*, the Western District of Texas also upheld an

[7] **(b)** Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may--
(1) enjoin the commencement or continuation of--
(A) any action against--
(i) a debtor with respect to property involved in such foreign proceeding; or
(ii) such property; or

injunction against specific property: "A court can enjoin all actions against a foreign debtor or against property of the debtor involved in the foreign proceeding." *In re Blackwell*, 270 B.R. 814, 825 (Bankr.W.D.Tex., 2001).

The injunctive power contained in Section 304(b)(1) has also been used in a broader manner similar to the automatic stay. In *George v. Parungao*, the Eleventh Circuit Court of Appeals dealt with this issue. 160 B.R. 1562 (11th Cir. 1988). The Court held that because the foreign representatives failed to qualify as "debtors" under the Code, they could not receive the protections of the automatic stay. *Id.* at 1563. Instead, the Court allowed them to proceed under Section 304 of the Code. *Id.* at 1568. In utilizing the flexibility offered by Section 304, the foreign representatives were able to petition for broad injunctive relief resulting in an outcome similar to an automatic stay.

In *Petition of Singer*, two foreign representatives utilized Section 304 relief to enforce an automatic stay granted under English law. 205 B.R. 355 (S.D.N.Y. 1997). In *Singer*, two Englishmen received the protection of the automatic stay under Section 130(2) of the English Insolvency Act of 1986. *Id.* at 356. They then sought an injunction in a Section 304 ancillary proceeding in the New York Bankruptcy Court, seeking to enforce the English automatic stay against all identified and unidentified creditors in the U.S. who were or could seek to enforce rights in the foreign debtor's U.S. property. *Id.* at 356-58. The Bankruptcy Court granted the injunction as to identified creditors, but not unidentified ones. *Id.* at 357. On appeal, the District Court overturned the bankruptcy court's ruling and imposed the injunction on both the identified and the unidentified creditors. *Id.*

In *Petition of Brierly*, the administrator of a foreign debtor petitioned for Section 304 relief enjoining U.S. creditors from suing the debtor or its property. 145 B.R. 151 (Bankr.S.D.N.Y. 1992). The Court granted the relief to prevent a piecemeal distribution of the U.S. assets outside of the foreign proceeding. *Id.* at 167. Interestingly though, the Court actually denied a portion of the petition that requested an extension of the injunction's protection to all the debtors' subsidiaries, direct and indirect. *Id.* at 168. The Court held "[b]ut a blanket injunction preventing suit against all of Headington's subsidiaries, direct and indirect, is not proper. The automatic stay which arises in the United Kingdom is no broader than ours in this regard; it protects the property of the particular company in administration." *Id.* at 169. In this

way, the Court actually limited the Section 304 injunction to effect a form of relief similar to the automatic stay.

In *re Starcom Service Corporation*[8] concurrent plenary proceedings were commenced under Title 11 of the Code and the CCAA in respect of a Washington State subsidiary of an integrated North American telecom enterprise. Some months later, rather than proceed with the Title 11 case, the U.S. Bankruptcy Court was asked to suspend the Title 11 proceedings and grant a far-reaching petition under Section 304 of the Code in respect of the CCAA proceedings. The scope of the injunctive relief granted in the Section 304 proceedings was sweeping and included relief under Sections 363 and 365 of the Code. The rights of all U.S. Creditors were required to be determined solely and exclusively in the CCAA proceedings and all U.S. Creditors were permanently enjoined and restrained from (a) taking any action adverse to the debtors or any of their property; or (b) from enforcing any judgments or liens against the debtors. In extending injunctive relief of that scope, the Court stated that it recognized that "the requested relief best assures the economical and expeditious administration [of the contested estates]" consistent with the balancing criteria established by Section 304 of the Code.

In proceedings under Section 18.6 of the CCAA, the breadth of stay orders granted tends to mirror those of a full plenary CCAA proceeding. As a typical example, in the recent ancillary proceedings relating to *Archibald Candy Corporation* and *Laura Secord Holdings Inc*. commenced February 2, 2004, the following relief was granted by the Ontario Superior Court of Justice pursuant to Section 18.6 of the CCAA:

> **STAY OF PROCEEDINGS**
>
> 5. **THIS COURT ORDERS** that no applications, suits, actions, demands, enforcement processes, extra-judicial or other proceedings, steps or grievances (each a "**Proceeding**") against or in respect of the Applicants or their respective property, assets and undertaking wheresoever located, and whether held by the Applicants in whole or in part, directly or indirectly, as principal or nominee, alone or in concert, jointly, beneficially or otherwise (collectively, the "**Property**") shall be commenced and any and all Proceedings against or in respect of the Applicants or the Property already commenced be and are hereby stayed and suspended.
>
> 6. **THIS COURT ORDERS** that no action may be commenced or continued against any of the members of the board of directors of the Applicants or their respective officers with respect to any claim against such directors or

[8] *In re Starcom Services Corporation et. al*., Bankr., W.D.Wa., M-98-6005, Nov. 20, 1998.

officers that arose before the date hereof and that relates to any obligations of the Applicant whereby the directors or officers are alleged under any law to be liable in their capacity as directors for the payment or performance of such obligations.

EXERCISE OF RIGHTS OR REMEDIES

7. **THIS COURT ORDERS** that the right of any person, firm, corporation, governmental, municipal or regulatory authority or other entity to file financing statements and/or financing charge statements, perfect or improve security, make demand, assert, enforce or exercise any other right (including, without limitation, rights to enforce security, to exercise lien rights, voting of shares, any right of foreclosure, garnishment, seizure, dilution, registration, attornment, encumbrance, buy-out, divestiture, repudiation, rescission, forced sale, acceleration, consolidation of accounts, repossession, distress, conversion, possession, termination, suspension, setoff of pre-existing obligations against rights which arise hereafter, modification or cancellation or right to revoke any qualification or registration), option or remedy arising by law, by virtue of any agreement (including, without limitation, any joint venture arrangement or agreement, any co-ownership agreement, collective agreement, purchase order, supply contract or lease, joint tenancy or tenancy in common) or by any other means (a) against the Applicants or the Property; or (b) as a result of any default or non-performance by the Applicants, the making or filing of these proceedings, the US Proceedings or any allegation or admission contained in these proceedings or the US Proceedings, be and is hereby restrained.

NON-INTERFERENCE WITH RIGHTS

8. **THIS COURT ORDERS** that except with the prior leave of this Honourable Court on notice to the Applicants, no person, firm, corporation, governmental, municipal or regulatory authority, or other entity shall cease, discontinue, fail to renew on reasonable terms, alter, interfere with (by delay or otherwise), claim any offset, deduction, diminutive of liability or responsibility under, or terminate any arrangement (including, without limitation, any lease or joint venture agreement or arrangement, joint tenancy or tenancy in common) agreement, right, contract, licence, permit or permission, written or oral (a) in favour of or held by the Applicants or in respect of the Property; or (b) as a result of any default or non-performance by the Applicants, the making or filing of these proceedings, the US Proceedings or any allegation or admission contained in these proceedings or the US Proceedings.

CONTINUATION OF SERVICES

9. **THIS COURT ORDERS** that all persons, firms, corporations, governmental, municipal or regulatory authorities, or other entities having written or oral arrangements, agreements or contracts with the Applicants or statutory or regulatory mandates for the supply of goods and/or services, including without limiting the generality of the foregoing, all ice cream, confectionery inventory or other merchandise for resale, all computer software, communication and other data services, maintenance, operation and installation services, internet connections, access to fibre optic and other cables and computer equipment, servers and switches, banking services, payroll servicing, insurance, transportation services, gas, heat, electricity, water, telephone, utility or other required services, by or to the Applicants or the Property are hereby restrained until further order of this Court from discontinuing, failing to renew on reasonable terms, altering, access codes or passwords, requesting deposits or other security, interfering with or terminating the supply of such goods and services so long as the normal prices or charges for such goods and services

> received after the date of this Order are paid in accordance with present payment practices of the Applicants, or as may be hereafter negotiated from time to time.

3. Sale Process

Section 304 of the Code does not specifically provide for running a sale process in an ancillary proceeding, nor does it specifically provide for the issuance of "free and clear" orders. However, subsection 304(b)(3)[9] does authorize U.S. Courts to grant "other appropriate relief". Congress intended this provision to allow flexibility to the courts: "[A] section 304 case is an ancillary case in which a United States bankruptcy court is authorized to apply its processes to give effect to orders entered in a foreign insolvency proceeding. Consistent with '[p]rinciples of international comity and respect for the judgments and laws of other nations,' Congress intended that the bankruptcy courts have 'maximum flexibility' in fashioning appropriate orders." *In re Goerg*, 844 F.2d 1562, 1567 -1568 (11th Cir., 1988).

Subsection 304(b)(3) comes with few restrictions on the court's inherent power to fashion relief. "The language of § 304(b)(3), providing that the bankruptcy court can order other appropriate relief . . . has been read simply as further indication of the broad discretion of bankruptcy courts under § 304 'to mold appropriate relief 'in near blank check fashion.'" *Haarhuis v. Kunnan Enterprises, Ltd.*, 177 F.3d 1007, 1012 (D.C. Cir., 1999).

In recent years, foreign representatives have been using this flexibility to request and obtain orders allowing assets to be sold free and clear of liens in a Section 304 proceeding. These types of orders effectively duplicate orders obtained under Section 363 and were obtained in the *Starcom* and *PSINet Limited*[10] ancillary proceedings, among others. In *Starcom*, assets of Canadian and U.S. based debtors located in the United States (both of which were subject to Section 304 proceedings ancillary to plenary CCAA proceedings) were vested in a purchaser "free and clear" of all claims of creditors subject to the jurisdiction of the United States' courts. The U. S. debtor had previously filed a plenary case under Title 11 of the Code in the State of Washington but subsequently asked for that case to be suspended (and ultimately discontinued)

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[9] **(b)** Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may--
(3) order other appropriate relief.

[10] (Bank., S.D.N.Y., 2001).

pending the completion of its Canadian plenary proceeding augmented by the ancillary relief afforded under Section 304 of the Code.

In the *PSINet* proceedings, substantially all of the assets of the PSINet group of companies located in Canada and certain assets located in the United States were included in a stalking horse bid process approved by both Canadian and US Courts in respective plenary proceedings and then given reciprocal effect in dual ancillary proceedings. Ultimately, those assets were vested "free and clear" in the purchaser through orders obtained firstly in the respective plenary proceedings and then recognized and given effect in the both Section 18.6 and Section 304 proceedings.

A further variant on this approach occurred in conjunction with the implementation of the plan with respect of the Loewen Group Inc.[11] In *Loewen*, the debtor had initially filed for protection under full plenary cases in both Canada and the United States. Notwithstanding the two plenary cases, the Ontario Superior Court of Justice recognized under Section 18.6 of the CCAA a plan put forward by the debtor solely under Title 11 of the Code and granted a vesting order transferring certain assets in furtherance of the US plan.

Likewise, in "stand alone" Section 18.6 proceedings, CCAA courts have used their broad discretion to permit stalking horse type bid processes to be conducted in respect of Canadian and US assets and vested those assets free and clear in subsequent purchasers. As an example, recent orders obtained in the *Archibald Candy Corporation* ancillary proceedings approved a section 363 auction for all assets, as well as provided for vesting of the assets in the successful bidder.

4. Dominion Over Assets

Given the broad scope of Section 304 of the Code, foreign representatives have also attempted to use Section 304 proceedings to obtain dominion over assets (particularly cash) located in the U.S. While U.S. Courts are comfortable with issuing injunctive relief, obtaining actual control over the property can be more difficult.

In deciding whether or not to turn over assets located within the U.S. to a foreign proceeding, courts must 1) determine whether the foreign party has an ownership interest in the

[11] Re: Loewen Group Inc. (2001), 32 CBR (4^{th}) 54 (Ont. S.C.J.)

property under the local law; and 2) determine whether the property is part of the bankruptcy estate under the applicable forum law. "In the turnover context, when an adverse claimant raises a plausible dispute concerning the ownership of the property sought to be repatriated, the court first must apply local law . . . to determine whether the debtor has a valid ownership interest in the property. Second, the court must apply the law of the foreign forum to determine if the property is part 'of [the] estate' of the debtor." *In re Rubin*, 160 B.R. 269, *274 - 275 (Bankr.S.D.N.Y. 1993); *see also In re Koreag, Controle et Revision S.A.*, 961 F.2d 341 (2nd Cir. 1992). U.S. Courts "may order turnover only of *property of* the foreign estate or its proceeds." *In re Rubin*, 160 B.R. 269, 274 (Bankr.S.D.N.Y. 1993).

After determining these threshold issues, the U.S. Courts look to factors set forth in Section 304(c)[12] of the Bankruptcy Code to determine whether or not they will order turnover or grant dominion over assets to foreign representatives. There is no uniform method by which courts analyze the factors set forth in Section 304(c). Every court has a different analysis and places greater or lesser emphasis on certain individual factors. The best way to analyze what factors are particularly important to a certain jurisdiction is to review case law from that specific jurisdiction. Little uniformity, if any, exists.

Generally, CCAA courts have not "turned-over" jurisdiction covering assets located in Canada to a foreign representative but have, instead, issued orders which: a) stay remedies against assets by domestic creditors; b) effect a co-ordinated disposition of assets pursuant to a court supervised sale process; and c) lead to a subsequent disposition or "pay-out" motion whereby the foreign representative can prove entitlement to proceeds. This type of approach is illustrated by the *PSINet* and *Archibald Candy Corporation* ancillary proceedings referred to above.

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[12] **(c)** In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with—
(1) just treatment of all holders of claims against or interests in such estate;
(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
(3) prevention of preferential or fraudulent dispositions of property of such estate;
(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
(5) comity; and
(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

5. Notice and Distributions

"The purpose of a § 304 case is to assist a foreign court in its administration of a foreign proceeding of liquidation or reorganization." *In re Artimm, S.r.l.,* 278 B.R. 832, 836 (Bankr.C.D.Cal. 2002). One of the manners in which a Section 304 proceeding may assist in the administration of a foreign proceeding is by providing notice to U.S. creditors of distributions in the plenary case. Likewise in Canadian foreign recognition proceedings, Canadian creditors may be required and compelled to participate in a U.S. based claims procedure, as occurred in the *Laidlaw* proceedings. For a more detailed discussion of the *Laidlaw* decision, please see pages 8 to 10 of the Sprayregen Paper, which follows.

6. Avoidance Powers

There has been some judicial discussion on whether or not an ancillary proceeding is an appropriate vehicle in which to bring an avoidance action under the Code. Early case law indicated that Section 304 proceedings were appropriate proceedings in which to pursue avoidance actions. *E.g., In re Trakman,* 33 B.R. 780, 783 (Bankr.S.D.N.Y.1983); *In re Egeria Societa Per Azioni Di Navigazione,* 26 B.R. 494, 497 (Bankr.E.D.Va.1983); *In re Comstat Consulting Services Ltd.,* 10 B.R. 134, 135 (Bankr.S.D.Fla.1981).

However, more recent cases indicate the opposite. "We thus hold that a foreign representative may assert, under § 304, only those avoiding powers vested in him by the law applicable to the foreign estate. Had Congress desired to vest a foreign representative with those domestic powers, it would have said so directly." *In re Metzeler*, 78 B.R. 674, 677 (Bankr.S.D.N.Y. 1987); *E.g., Matter of Axona Intern. Credit & Commerce Ltd.,* 88 B.R. 597, 607 (Bankr.S.D.N.Y. 1988); *In re Lines,* 81 B.R. 267, 270 n. 1 (Bankr.S.D.N.Y. 1988); *In re A. Tarricone, Inc.,* 80 B.R. 21, 23 (Bankr.S.D.N.Y. 1987); *In re Metzeler,* 78 B.R. 674, 677(Bankr.S.D.N.Y. 1987). *See also* 2 *Collier Bankruptcy Practice Guide* par. 19.07(1)(1988).

The prevailing view in the United States is that an ancillary proceeding is an inappropriate forum in which to bring an avoidance action that arises under the Code. Consequently, a foreign representative may not be able to utilize the Code provisions to void a transfer in an ancillary proceeding. The result is murkier, however, when the foreign representative seeks to void a transfer in an ancillary proceeding pursuant to the laws of the foreign jurisdiction.

As stated above, there are two basic approaches to ancillary proceedings: 1) territorialist; and 2) universalist. Territorialists would argue that the avoidance law of the ancillary proceeding's jurisdiction should always apply. Universalists would argue that the avoidance laws of the foreign jurisdiction should always apply. Given the United States' general universalist approach to ancillary proceedings, the courts could decide to interpret or apply the laws of the foreign jurisdiction, and thus apply those avoidance provisions to U.S. based transactions.

We are unaware of Canadian courts having embraced the idea of permitting Section 18.6 proceedings to assist in implementing foreign based avoidance laws on powers. Given the circumspection exercised by Canadian courts in dealing with cross-border insolvencies, we suspect that Canadian courts will be inclined to consider whether there are substantive differences in treatment under foreign law and Canadian law before providing recognition of avoidance rights under Section 18.6 of the CCAA. However, given the breadth of relief afforded to date in ancillary proceedings, it would not be surprising if this aspect of cross-border insolvency practise became more advanced.

7. DIP Financing

In Section 18.6 proceedings, Canadian courts have exercised broad discretion to recognize a U.S. order issued pursuant to Title 11 of the Code granting liens over assets to secure post-petition financing and the priority of certain court ordered charges. See, for example, the Order made by the Ontario Superior Court of Justice on February 2, 2004 in *Re Archibald Candy Corporation et. al.* In that order, the Court not only recognized the US Court's order authorizing secured post petition financing on a super priority basis but it also granted a fixed and specific charge against the debtor's property located in Canada. Also notable are: a) the *Babcock and Wilcox Canada* ancillary proceedings where a solvent Canadian subsidiary of a Chapter 11 debtor became subject to Section 18.6 proceedings and was permitted to guarantee the post-petition financing obligations of its parent and grant additional security to the post-petition lender to secure payment of same; and b) the *Androscoggin Energy LLC* ancillary proceedings where a court ordered "administrative charge" overall of the debtor's property in favour of counsel and other preferences was granted by the CCAA court to secured professional fee expenses.

Conclusion:

Ancillary proceedings under Section 304 of the Code and Section 18.6 of the CCAA have traditionally been seen as the proverbial "tail" to the foreign proceeding's "dog." They are meant to facilitate the administration of an insolvency case by applying principles of comity and deference, to a point, to the laws of the main proceeding. Although creative use has been made of the foreign proceeding provisions to date, we foresee an expanding scope of relief being requested, and granted, as bench and bar meet the challenges proposed by international insolvency. At some point, however, courts may need to articulate appropriate policy limits on ancillary relief, exercise restraint and avoid granting ancillary relief that could effectively "wag" the main proceeding's "dog". Otherwise, the universalist model of deference in ancillary proceedings to a principal jurisdiction will become increasingly blurred and may morph into a hybrid model somewhere short of the protections afforded in co-ordinated, dual plenary proceedings.

SCHEDULE "A"

Section 304 of the Code

304 **(a)** A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.
(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may—

(1) enjoin the commencement or continuation of—
(A) any action against--
(i) a debtor with respect to property involved in such foreign proceeding; or
(ii) such property; or
(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;
(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or
(3) order other appropriate relief.
(c) In determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with--
(1) just treatment of all holders of claims against or interests in such estate;
(2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding;
(3) prevention of preferential or fraudulent dispositions of property of such estate;
(4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
(5) comity; and
(6) if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns.

Section 18.6 of the CCAA

18.6(1) Definitions In this section,
"foreign proceeding" means a judicial or administrative proceeding commenced outside Canada in respect of a debtor under a law relating to bankruptcy or insolvency and dealing with the collective interests of creditors generally;
"foreign representative" means a person, other than a debtor, holding office under the law of a jurisdiction outside Canada who, irrespective of the person's designation, is assigned, under the laws of the jurisdiction outside Canada, functions in connection with a foreign proceeding that are similar to those performed by a trustee in bankruptcy, liquidator or other administrator appointed by the court.
18.6(2) Powers of court
The court may, in respect of a debtor company, make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a co-ordination of proceedings under this Act with any foreign proceeding.

18.6(3) Terms and conditions of orders

An order of the court under this section may be made on such terms and conditions as the court considers appropriate in the circumstances.

18.6(4) Court not prevented from applying certain rules

Nothing in this section prevents the court, on the application of a foreign representative or any other interested person, from applying such legal or equitable rules governing the recognition of foreign insolvency orders and assistance to foreign representatives as are not inconsistent with the provisions of this Act.

18.6(5) Court not compelled to give effect to certain orders

Nothing in this section 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.

18.6(6) Court may seek assistance from foreign tribunal

The court may seek the aid and assistance of a court, tribunal or other authority in a foreign proceeding by order or written request or otherwise as the court considers appropriate.

18.6(7) Foreign representative status

An application to the court by a foreign representative under this section does not submit the foreign representative to the jurisdiction of the court for any other purpose except with regard to the costs of the proceedings, but the court may make any order under this section conditional on the compliance by the foreign representative with any other order of the court.

18.6(8) Claims in foreign currency

Where a compromise or arrangement is proposed in respect of a debtor company, a claim for a debt that is payable in a currency other than Canadian currency shall be converted to Canadian currency as of the date of the first application made in respect of the company under section 10 unless otherwise provided in the proposed compromise or arrangement