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9 — Air Canada and Stelco: Legal Developments and Practical Lessons

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I. — Introduction

The restructurings of Air Canada[2] and Stelco[3] under the *Companies' Creditors Arrangement Act*[4] (CCAA) were two of the largest and most challenging restructurings ever conducted in Canada. During the course of both restructurings, many strategies were employed, some of which were successful, others were not. Both cases involved intense conflict among divergent stakeholder groups, resulting in a multiplicity of motions and judgments, as well as many trips to the Court of Appeal. The cases together generated over 100 Monitor's Reports and 15 separate matters heard by the Court of Appeal. Significant legal precedents were established, and practical lessons were learned — both of which will have far reaching implications for future large restructurings in Canada.

To catalogue and explore all of the developments in the law and practice of CCAA restructuring arising from the Air Canada and Stelco experiences would fill a book. However, the authors have attempted to compile some of the more significant of these for the benefit of practitioners, academics, and others.[5] In particular, we will compare:

(i) the background facts that motivated both filings;

(ii) critical issues arising at the outset of both proceedings, namely the DIP cross-collateralization for pre-filing liabilities in *Air Canada* and the question of whether Stelco was insolvent in *Stelco*;

(iii) appropriate regulatory exemptions from the scope of the initial stay;

(iv) the state of the law on set-off;

(v) the role of the Monitor; and

(vi) strategies for negotiating with major stakeholders, in particular, strategies for dealing with unions in large restructurings.

II. — Background of Filings

From a certain perspective, there are a number of similarities between Air Canada and Stelco, particularly with respect to the background circumstances that led to their respective decisions to seek relief under the CCAA.

Both companies were large, well-known, even historic Canadian public corporations. Air Canada was, and remains, Canada's largest airline, having been in business since 1937 at the dawn of the commercial airline industry. The site of Stelco's Hamilton plant has been a steel mill for more than 100 years, and Stelco is Canada's largest integrated steel producer.

Both corporations had large, unionized work forces and both had a history of troubled labour relations. Both were burdened with significant unfunded "legacy costs" in respect of retired employees and both had defined benefit pension plans. The pension plans collectively had significant solvency deficits, approximately $1.3 billion in both cases. Furthermore, both the airline industry and the steel industry in North America were under financial stress. In both cases, significant competitors had undergone, or were in the process of undergoing, restructurings. In the U.S., cases under Chapter 11 of the U.S. *Bankruptcy Code* in the airline industry included United Airlines, US Air, Continental, Northwest, and Delta Airlines. In the steel industry, International Steel Group was formed by the purchase of the assets of LTV Steel, Acme Steel, and Bethlehem Steel out of bankruptcy proceedings. Canadian insolvency proceedings included Canadian Airlines, Canada 3000, and Algoma Steel (twice).

In particular, the initial application records filed by both companies noted the following common elements as contributing to the financial position of the companies that needed to be restructured as part of the proceeding:

- excessive labour costs,
- excessive pension deficits,
- uncompetitive cost structures,
- intense competition in their respective industries, and
- rising supply prices.

From this perspective, one might be forgiven for expecting that the restructurings would proceed along similar paths and reach similar conclusions.

Both restructurings were heavily contested and highly litigious. Both suffered from antagonistic and intransigent stakeholder groups with diverse interests. However, the restructurings proceeded along different routes (both convoluted) leading to dramatically different results. It is to the differences, then, rather than the similarities, that one must look to achieve some degree of enlightenment as to what happened in the restructurings and, more importantly, why it happened as it did.

Principal among the distinctions that put Air Canada's restructuring on a different course than that ultimately followed by Stelco was the existence of an *actual* severe financial crisis at Air Canada from the on-set of its filing, whereas Stelco filed at a time of deteriorating financial health but in *anticipation* of an imminent financial crisis. In the case of Air Canada, subsequent events, such as the eruption of the war in Iraq and the outbreak of SARS in Air Canada's main hub of Toronto, exacerbated an already deteriorating financial situation. In the case of Stelco, steel prices spiked in an unprecedented fashion to unforeseeable heights, turning the financial difficulties forecasted at the time of the filing into periods of record profit. While the term "record profit" is generally welcome in the boardrooms of corporate Canada, it had a decidedly chilling effect on the willingness of stakeholders to contribute to the economic restructuring of Stelco. More than any other factors, the existence, severity, and palpability of a financial crisis, or lack thereof, were the distinguishing features that drove the restructurings of Air Canada and Stelco in different directions and that led, at least with respect to some major stakeholders, to dramatically different results.

This article will describe the background facts, the strategies employed for dealing with those facts, and the manner in which issues were resolved in both proceedings. In many cases, the issues are common to both restructurings. The authors will analyze the developments in the law arising from such events, all with a view to providing practical advice regarding future large corporate restructuring efforts in Canada.

III. — Day One Comeback Issues: Dip Cross-Collateralization and Anticipated Insolvency

1. — Air Canada

As noted above, according to the material filed in support of Air Canada's initial application,[6] Air Canada was under severe financial pressure and was finally forced to seek relief when the federal regulator, the Office of the Superintendent of Financial Institutions Canada (OSFI), exercised its statutory right to require Air Canada to file an updated pension valuation. Under the federal pension regulatory regime then applicable to Air Canada, such would have likely required it to make additional payments into its pension plans that, absent the stay provided for pursuant to the CCAA filing, would have resulted in Air Canada's inability to meet its ongoing commitments and continue in operation. The decision to file and the timing of the filing, in the case of Air Canada, was therefore driven in significant measure by the acts of creditors. However, ignoring the anticipated additional payments that a new pension valuation would require, the material filed showed that Air Canada's operations as of the time of filing were causing a staggering cash drain of approximately $2 million per day. Its liquid resources were reduced to a mere $360 million at the time of filing that, in the words of Air Canada's counsel at the time, was close to "flying on fumes". Similar to the later Stelco filing, Air Canada's decision to file was prompted in part by anticipated future events, particularly the significant additional funding that would likely be required if the requested pension valuation had occurred. The existing cash flow situation, particularly the enormous "cash burn" rate, was tangible and convincing evidence that Air Canada was in need of a financial overhaul and that the *status quo* was not sustainable. With mounting cash losses and a balance sheet showing a deficit in retained earnings of $1.9 billion, no one questioned whether Air Canada qualified for protection under the CCAA. More importantly, no one doubted that Air Canada would need an extensive financial overhaul to survive and that all major stakeholders would be required to contribute to the restructuring.

Of particular concern to Air Canada was the effect that an insolvency filing would have on its continued operations, including continued bookings by the flying public. It was important for critical suppliers and the customer base to know that Air Canada had sufficient liquidity to ensure that the company would not run out of cash before the restructuring was completed. Although restructurings of major airlines were underway in the United States, the "book away" factor (customers migrating to competitor airlines) was considered to be a significant risk, particularly in the absence of sufficient liquidity reserves. An adverse public perception from the initiation of the proceeding would increase the risk of a waterfall effect of ever-increasing cash shortfalls resulting from declining revenue as passengers migrated to competitors before cost-cutting measures could be implemented. This could have created a "death spiral" for the company.

As a result, Air Canada requested, as part of the Initial Order, a secured DIP loan of US$700 million, representing almost CDN $1 billion at the exchange rates then prevailing, to assure employees, suppliers and the flying public that Air Canada had the financial wherewithal to remain in operation as a viable, reliable, and safe airline. It was the largest DIP facility ever offered in Canadian history.

Air Canada was able to negotiate a term sheet with respect to the DIP loan with GE Capital Aviation Services, Inc. (GECAS) and its affiliates over the weekend prior to the initial filing. Air Canada was fortunate in that its proposed lender had considerable experience both in DIP financing (in Canada and the U.S.) and in financing in the airline industry worldwide. However, there was a unique feature associated with the DIP financing offer that had significant implications for the Air Canada restructuring and even broader implications for Canadian law and restructuring practice. The priority charge given under the DIP facility also stood as security for any shortfall suffered in respect of 22 specifically identified aircraft leased by Air Canada from or through GECAS. This has subsequently become known as the "DIP cross-collateralization" since the DIP charge secured both new advances to be made under the DIP charge and these specified pre-filing obligations. [7] Furthermore, as reported by the Monitor in its First Report, the potential obligations in respect of the specified aircraft totalled, at the date of filing, approximately US $400 million. [8] The cross-collateralization issue was therefore significant.

It also turned out to be controversial. Not surprisingly, other creditors took exception to the request for a court-sanctioned charge for pre-filing obligations.

Farley J. granted the AC Initial Order, including the DIP charge and cross-collateralization, on April 1, 2003. In the course of doing so, he made it clear that, although the AC Initial Order was to be granted in the form requested, any party was free to return to court under the "comeback" clause of the order. He further stated that the fact that he approved the AC Initial Order was to have no effect upon the onus that such creditor would have to meet in seeking to alter the terms of the order. He further established a specific hearing date for the purpose of reconsidering the DIP loan and cross-collateralization provisions and other sections of the AC Initial Order after a hiatus of 21 days. In doing so, Farley J. balanced Air Canada's expressed need for the stability rendered by the existence of the DIP loan at the outset of the filing while at the same time giving all other stakeholders an opportunity to present Air Canada with a DIP financing alternative on better terms, particularly without a cross-collateralization feature. Farley J. also received Air Canada's undertaking to advise the stakeholders prior to making any draws under the DIP facility if that became necessary prior to the comeback date. [9] In this way, Farley J. assisted in fostering a climate of stability and confidence in the marketplace while opening the door for other stakeholders to improve upon the terms of the DIP financing, if possible.

In the end, no other DIP financing proposals were received by Air Canada, and the proposed DIP financing, including the cross-collateralization feature, was approved. In approving the cross-collateralization, Farley J. noted that, although the security would secure pre-filing obligations and as such might be referred to as a preference, the Insolvency Institute of Canada had recommended to Parliament in its recommendations on insolvency law reform that the court be given specific authority to approve preferences in certain circumstances. [10] It should be noted that there were no pre-existing secured creditors in Air Canada and that leased aircraft were exempt from the collateral pool covered by the charge.

Many have questioned the wisdom of allowing a cross-collateralization feature in DIP loans, but the process should be regarded as well established. It was allowed, without fanfare, in the Stelco restructuring [11] and has occurred in other cases. [12] In addition, the proposed amendments to the CCAA allow the court to grant DIP financing "on any conditions that the court considers appropriate". [13] This broad language, if proclaimed, would clarify that the court may grant DIP loans that secure the DIP financer's previous indebtedness with the debtor company in addition to post-filing advances in appropriate circumstances.

As a matter of principle, it must be taken as established that the court has jurisdiction under the statutory language of s. 11 of the CCAA (as opposed to inherent jurisdiction) to impose conditions of the stay, including the granting of prior-ranking security even over the objection of pre-existing secured creditors. [14] There would seem to be no legal impediment to the court exercising the same statutory jurisdiction to expand the scope of the DIP charge (for pre-filing and post-filing obligations) also over assets that are subject to pre-existing security, again in appropriate circumstances. However, such jurisdiction should be exercised sparingly, probably only in dire circumstances.

It is well established that an act of payment or the granting of security will not be considered to be a voidable preference if the purpose and intent of the transaction was to stay in business as opposed to obtain a preference. [15] This was precisely the test met by the *Air Canada* case, albeit on a grandiose scale. The terms of the DIP financing were clearly stated. The provisions of the DIP facility as negotiated, including the cross-collateralization feature, were to be treated as an indivisible whole, not a menu of items from which stakeholders could pick and choose at their option. [16] Air Canada exercised its business judgment in requesting the DIP loan as a necessary feature of its restructuring efforts. Air Canada determined that it required the DIP loan, upon the terms negotiated, as a critical feature of its ability to stay in business. The terms of the DIP facility, including the cross-collateralization feature, were fully disclosed to the court and all stakeholders, and an opportunity was given to the stakeholders and the lending community at large to offer better terms, but no offers were forthcoming. These three features: (1) the exercise of a debtor's business judgment as to what is necessary to stay in business; (2) full, prompt disclosure of the terms to the stakeholders and the court; and (3) an opportunity to obtain alternate financing on better terms, justified the court sanctioning cross-collateralization for pre-existing claims in the Air Canada situation and should provide guidance to future courts when dealing with this issue.

However, in keeping with the flexibility inherent in the CCAA, the circumstances in which the court should determine that cross-collateralization is appropriate should not be the subject of definitive enumeration. The court should exercise its jurisdiction to approve such transactions whenever the court feels that it is necessary or desirable to do so in the interests of facilitating the restructuring of a debtor. It should be open to debtors, stakeholders, and judges supervising future cases to determine when it is appropriate, based on the facts that may then be before the court. To attempt to dictate the circumstances when cross-collateralization is or is not appropriate would be an effort that would tend to drive the "principle-based" CCAA restructuring process toward the less satisfactory "rules-based" process, such as is found in restructurings under Chapter 11 of the U.S. *Bankruptcy Code*.

On a practical note, insolvency advisors should remind their clients of the need to be "nimble" when involved in a CCAA restructuring. "Nimble" in this context means creative, decisive, and quick. The *Air Canada* case illustrates that a stakeholder that commits money to a financial restructuring is in a preferred position to one that does not. Stakeholders that do not have resources to commit to financing, on either an interim/DIP basis or as part of an exit facility or plan restructuring, would be well advised to align themselves with one or more of the numerous lenders that now specifically target distressed situations as prime lending opportunities, the number of which has increased significantly in recent years. [17]

Some commentators have questioned the wisdom of allowing the Air Canada cross-collateralization under its DIP loan. Such speculation is an exercise in hindsight with considerably less clarity than 20/20 vision. At the end of the day, Air Canada's restructuring was a long battle, the outcome of which was often in considerable doubt. The odds of a different, materially less-favourable outcome would have been greatly increased had Air Canada started its restructuring process in a pitched battle with its major creditors and with little liquidity available to it. Instead, the issue was deftly handled by Farley J. in a way that: (a) balanced the urgent interests of Air Canada as they appeared on the day of filing; (b) enhanced the stability of the airline; (c) provided a much needed calming effect on Air Canada's customers; and (d) preserved options for the complaining stakeholders. In Air Canada's case, this important first step in the restructuring process supported the old adage, "Well begun is half done." [18]

2. — Stelco

Stelco is a different story. A more apt adage would be: "The best laid plans of mice and men often go awry." [19]

The conventional wisdom of insolvency practitioners has been that the sooner the financial crisis can be identified and a filing made, the more restructuring alternatives will be open to the debtor company and its stakeholders with better possibilities and potential outcomes for all involved. The Stelco restructuring saga is a casebook testament to the need to critically assess the application of conventional wisdom to any particular fact situation.

Stelco responsibly identified that, as at the date of its filing, the company was losing money (at the rate of approximately $30 million per quarter [20] or approximately $300,000 per day). Although it had not yet run out of liquidity, it estimated that it would do so by approximately November of that year (some nine months later). As submitted by counsel for the debtor on the initial application, Stelco was like an ocean liner and one could not expect it to turn around on a dime. It was anticipated that the restructuring would take a number of months (a reasonable estimate at the time that, nevertheless, turned out to be a gross underestimate). The application was being brought in sufficient time to allow Stelco to engage in the necessary restructuring activities so that it could emerge prior to using the last of its then available liquidity.

The union locals immediately cried foul. They submitted to Farley J. that Stelco was not in default of any of its current obligations, that it was not insolvent, and that it therefore did not qualify for protection under the CCAA. Immediately out of the gate, Stelco found itself embroiled in a fundamental attack upon the CCAA process from an important stakeholder. As with Air Canada, Farley J. granted the Stelco Initial Order to bring stability to the restructuring effort on the basis that anyone concerned about any of the terms of the Stelco Initial Order could use the comeback clause on a timely basis. [21] He again clarified that the onus remained on Stelco to justify the relief. [22] In response, Local Union Nos. 1005, 5328 and 8782 of the United Steelworkers of America (U.S.W.) brought a motion seeking, among other relief, to rescind the Stelco Initial Order on the basis that Stelco was not insolvent. The motion was heard March 5, 2005, approximately one month after the initial filing.

Farley J.'s decision of March 22, 2004 [23] is interesting from a number of perspectives that have implications for practitioners in the area. Firstly, since the CCAA does not define "insolvent", Farley J. referred to the definition of "insolvent person" in the *Bankruptcy and Insolvency Act* [24] (BIA), which is a three-prong disjunctive test. On the facts as they were adduced before him, Farley J. found that Stelco failed prong (c) of the test, which is "an assets compared to obligations test" [25] and has also been called the "balance sheet test". This prong of the test deems a person insolvent if "the aggregate of [its] property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all [its] obligations, due and accruing". [26] Farley J. found that the total realizable value of the assets of Stelco did not exceed its liabilities and that Stelco was "significantly, not marginally, under water". [27] He included in this liability calculation the going concern deficiency of the Stelco pension plans.

It is possible to value pension plans in a variety of ways, including by reference to going concern funding obligations, solvency deficiencies, and wind-up deficiencies, all of which result in a different size of obligation owing and any of which might arguably have been used to determine whether Stelco was insolvent. In light of this, the issue of how to define the scope of "obligations, due and accruing" was hotly contested. Farley J., taking a contextual approach to the interpretation of the statute, determined that under the third prong of the definition there could not be "orphan" obligations left unsatisfied if there are no residual assets and undertaking to pay off any such obligations. As a result, he determined that the phrase "obligations, due and accruing" was meant to capture all obligations of whatever nature or kind, leaving nothing in limbo.[28] The evidence of Stelco's chief restructuring officer in respect of Stelco's pension obligations was based on the going concern funding deficiency, under which calculation the liability is estimated most conservatively. However, Farley J. indicates that in his view the wind up deficiency, which was almost double the going concern funding deficiency, could have been used, in which case the result would have been "even bleaker".[29] In so examining the assets and liabilities, Farley J. rightly found that Stelco was insolvent within test (c) under the BIA. Farley J.'s findings and reasons on this point were unassailable on the factual record before him, and the *ratio* of the case is to be found in this aspect of his reasons.

Sparking greater interest with commentators is the additional *obiter* of Farley J. wherein he considers the fact that the CCAA does not necessarily require him to look to the BIA definition of "insolvent person" to determine whether a debtor company is "insolvent" under the CCAA. He relies on a purposive interpretation of the CCAA, quite rightly in the authors' view, to suggest that it was open to him to define "insolvent" for the purposes of the CCAA in a manner that is broader than that found under the BIA, having regard to the CCAA's broad intent as a remedial statute to facilitate the restructuring of companies. He stated as follows:

> It seems to me that given the time and steps involved in a reorganization, and the condition of insolvency perforce requires an expanded meaning under the CCAA. Query whether the definition under the BIA is now sufficient in that light for the allowance of sufficient time to carry through with a realisticallyviable proposal within the maximum of six months allowed under the BIA? I think it sufficient to note that there would not be much sense in providing for a rehabilitation program of restructuring/reorganization under either statute if the entry test was that the applicant could not apply until a rather late stage of its financial difficulties with the rather axiomatic result that in situations of complexity of any material degree, the applicant would not have the financial resources sufficient to carry through to hopefully a successful end. This would indeed be contrary to the renewed emphasis of Parliament on "rescues" as exhibited by the 1992 and 1997 amendments to the CCAA and the BIA.
>
> ... It seems to me that the CCAA test of insolvency advocated by Stelco and which I have determined is a proper interpretation is that the BIA definition of (a), (b) or (c) of insolvent person is acceptable with the caveat that as to (a), a financially troubled corporation is insolvent if it is reasonably expected to run out of liquidity within reasonable proximity of time as compared with the time reasonably required to implement a restructuring. That is, there should be a reasonable cushion, which cushion may be adjusted and indeed become in effect an encroachment depending upon reasonable access to DIP between financing.[30]

This interpretation is entirely consistent with the widely recognized rule of statutory interpretation that directs the court to take a contextual and purposive approach to the language of an Act and is consistent with the conventional wisdom that companies should not wait until the last moments of their "death throes" to seek assistance by way of a filing. Farley J. found that it was appropriate, in determining whether a company was "insolvent" within the meaning of the CCAA, to factor in the length of time necessary to effect a restructuring and to consider that time period in relation to the financial forecasts presented to determine whether a debtor is entitled to CCAA protection. In this case, Farley J. determined that Stelco was entitled to consider that it would need a reasonably foreseeable period of time within which to attempt to implement the restructuring and to factor that period into the timing of its decision as to whether to seek protection. Farley J.'s decision validated Stelco's analysis of the need for a filing and represented an initial victory for Stelco in its restructuring effort.

The danger, of course, with relying upon a future anticipated state of events to justify a restructuring is that the future may not unfold as predicted. Financial forecasts may be sufficient to establish jurisdiction for the purposes of obtaining protection under the CCAA, but they were not sufficient, in Stelco's case, to convince the stakeholders, particularly those representing employees and pensioners, that concessions were necessary on their part. While Farley J.'s decision is good law (leave to appeal to the Court of Appeal was dismissed [31] and further leave to appeal was denied by the Supreme Court of Canada [32]), it must fairly be said that jurisdiction to initiate proceedings under the CCAA does not a restructuring make.

In the authors' experience, in the vast majority of CCAA restructuring cases, the financial health of the debtor company immediately after the filing may stabilize somewhat, but generally remains in poor condition and, in most cases, deteriorates more than expected due to the vagaries inherent in the restructuring process, including those that are crystallized by the public admission of insolvency. In other words, things rarely go better than planned. Stelco was the exception to this rule. The profitability of Stelco was driven, to a significant extent, by the price of steel, the benchmark for which is hot rolled steel, one of Stelco's products. This benchmark price, and other prices for steel, dramatically increased in early 2004 (Stelco filed January 29, 2004), and this pricing sustained itself for about a year. The spike was both historically precipitous and to record heights driven primarily by an unexpectedly large appetite for steel in the emerging markets of China and India. Appendix "A" is a chart prepared by the Monitor and reproduced with permission from Ernst & Young Inc. graphically depicting the change of circumstance that fundamentally altered the prospects for Stelco with reverberations throughout the restructuring in terms of the negotiating leverage of the company and various stakeholders. Appendix "A-1" has been altered to show the graph of prices up to the date of filing and Appendix "A-2" includes most of the post-filing period. A comparison of the two graphically illustrates the surprising future that was in store for Stelco after its filing.

As disclosed by Stelco during the proceedings, the company's net earnings by quarter commencing Q1 of 2004, in which the filing occurred, through Q1 of 2006 (at emergence) is described below. We set out, in the same chart, the quarterly net earnings for the two years prior to the filing by way of comparison.

Stelco Inc. Quarterly Comparison of Net Earnings (Loss) for Years 2002-2006{32}
(In millions)

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2002	2003	2004{33}	2005	2006												
Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
(31){34}	6	6	20	(44)	(83)	(42)	(395)	(37)	42	58	1	49	40	(42)	(120)	(122)
Pre-Filing Period	Filing Period															

Notes: 32 Financial Year-End: December 31.33 Under CCAA Protection as of January 29, 2004.34 In 2003, 2004 and 2005, Stelco Inc. adopted new accounting policies with retroactive application to the prior years. The restated results are used.

This fundamental change of economic circumstances made it extremely difficult for Stelco to extract concessions from stakeholders and represents a sharp contrast to the factual matrix at play in the Air Canada restructuring regarding similar constituents. Simply put, organized labour and pensioners were not prepared to negotiate significant concessions during periods of record profit.

This highlights a risk to be weighed by practitioners in determining whether and when to seek relief under the CCAA. While the traditional wisdom has been that early filings make for better restructurings, a mere anticipated crisis is not as compelling as an actual crisis to evoke concessions, and there is always a risk, usually considered remote, that the anticipated crisis will never develop. The necessary brinkmanship negotiating dynamic cannot be brought to bear to drive the process if there is no credible threat of an adverse alternative to a restructuring. [33]

So, does the conventional wisdom about filing early need to be rethought? The authors answer, “No”. It remains true that commencing a restructuring process before the final “death throes” preserves options and therefore enhances the chances of a successful restructuring. It is also true that things usually go worse than management anticipates. In the majority of cases, the issue of concern is that there are too many crisis points, not too few. In this regard, Stelco is the exception that proves the rule. Practitioners should always consider, however, what might happen if the traditional management “hockey stick” projection [34] comes true. Management and the professionals involved must be able to react quickly to recalibrate the goals to be achieved by the restructuring in light of the revised facts as they develop. This is as true for adverse developments in the financial health of a debtor as it is for positive ones.

On a more theoretical note, the willingness of Farley J. to read an expansive definition of “insolvency” into the CCAA to give effect to its remedial purpose should be considered as instructive not only with respect to the CCAA, but other Acts that use similar terms, particularly the *Canada Business Corporations Act* [35] (CBCA). For example, plans of arrangement under s. 192 of the CBCA are applicable for companies that are “not insolvent”. “Insolvent” is defined, however, this definition is different than the BIA definition of “insolvent person”. Some may think that a bright line exists wherein companies that meet the BIA definition of “insolvent person” should be restructured under the CCAA, whereas federal companies that are “not insolvent” should be restructured under the CBCA. Farley J.’s decision suggests that the Acts may not be so compartmentalized, but may be subject to areas of overlap. One should interpret both Acts with a view to fulfilling the purpose and intent of each piece of legislation. This leads to the possibility that a corporation that may or may not meet the BIA definition of “insolvent person”, may be “insolvent” for the purpose of obtaining protection under the CCAA and may be “not insolvent” for the purpose of restructuring the shares of that corporation under a CBCA plan of arrangement, all at the same point in time.

Some may find this to be a confusing or contradictory result. It is not, nor should it be considered so. All of the statutes under consideration are remedial, and the law is clear that they should be given a broad and liberal interpretation so as to fulfil their purpose. As a practical matter, many large corporate restructurings need to both deal with the creditors of the corporation and alter the existing share structure. While complicated corporate machinations exist to achieve the necessary results, the simultaneous application of the plan of arrangement sections of the CBCA and the CCAA will increase the options available to creative counsel as well as their clients and is therefore a result to be encouraged. It is not inconsistent to determine that, at the same time, an entity may be solvent for the purpose of one Act and insolvent for the purpose of a different Act. The courts are on sound legal footing in asserting jurisdiction in such cases so as to afford an effective and practical remedy to parties seeking to restructure both the debt and the equity of a corporation. Such an interpretation is mandated by the recognized canons of statutory interpretation. The decision of Farley J. is correct in law, and the concept that underlies it should be expanded in scope and application to other Acts to optimize the restructuring process in Canada for the general benefit of debtors and their stakeholders.

IV. — Extent of Initial Stay: “Four Pillars” of Regulatory Exemption

It is not surprising that air transportation is among the most highly regulated industries in Canada. Also unsurprisingly, much of this regulation is targeted at what has been described as the “four pillars”: health, safety, security, and airworthiness. However, given the importance of the national transportation infrastructure, the airline industry is subject to a much broader range of regulation, in particular, in respect of finance and capitalization, competition, accessibility, and employment issues.

To make matters even more difficult for Air Canada, the airline was subject to an added level of regulation due to the company’s unique position as the former national flag carrier and dominant market player. For example, the airline was the only market participant subject to the *Air Canada Public Participation Act* [36] (ACPPA), which was enacted to implement Air Canada’s transition from Crown corporation to public company. Among other things, pursuant to the ACPPA, Air Canada and its subsidiaries were subject to Canada’s *Official Languages Act* [37] and were thus required to make services available in both official languages. These types of additional regulatory obligations reduced Air Canada’s competitiveness by burdening the airline with the additional costs associated with compliance.

It is difficult to imagine that Parliament intended that an airline under CCAA protection should be able to operate in a completely unregulated environment; indeed, no sane person would suggest that a company in *any* industry (much less one as potentially dangerous as air travel) should be permitted to ignore basic health and safety concerns simply because it is restructuring. Likewise, it also seems apparent that Parliament did intend that at least *some* level of regulatory oversight should be suspended during a CCAA restructuring, particularly if such oversight would unduly interfere with management's reorganization efforts and/or otherwise threaten the viability of the reorganization plan. [38]

What was not clear in the *Air Canada* case was exactly where the dividing line fell between regulation that was immune from, and regulation that was susceptible to, the CCAA stay of proceedings.

1. — Temporal Stay of Regulatory Proceedings

The issue of exactly where the dividing line fell between immune and susceptible regulation arose early in the *Air Canada* proceeding. The AC Initial Order did not make any distinction; para. 5 of the AC Initial Order contained a general stay of proceedings that restrained the right of any governmental authority to assert, enforce or exercise any right, option or remedy including those arising by virtue of any default or non-performance by Air Canada. However, para. 19 obliged the airline to "continue to operate, maintain, insure, inspect, service, repair and overhaul all aircraft" in the ordinary course and in accordance with accepted airline industry standards and practice. Thus, the effect of the AC Initial Order was to stay *all* regulatory activity, while maintaining Air Canada's obligations in respect of airworthiness.

A number of federal regulatory bodies, and in particular, the Canadian Transportation Agency (CTA), objected as a matter of principle to the terms of the AC Initial Order. The CTA is an independent, quasi-judicial administrative tribunal, which reports to Parliament through the Minister of Transport. In addition to being the economic regulator of the federal transportation network, the CTA has a limited human rights mandate under Part V of the *Canada Transportation Act*. [39] The CTA is responsible for matters governed by the *Canada Transportation Act* and certain related legislation insofar as such matters affect rail, air, and marine activities within federal jurisdiction. In respect of airlines, the CTA's regulatory duties include such consumer protection matters as ensuring access to air travel for persons with disabilities, by investigating complaints of undue obstacles to the mobility and ensuring any such obstacles are removed from federal transportation services and facilities; protecting consumer interests through an air travel complaints program; and ensuring that air carriers provide appropriate notification before reducing or discontinuing domestic air services. The CTA is also charged with economic regulatory duties, including investigating complaints regarding domestic fares and cargo rates on non-competitive routes.

Air Canada took the position that in order to successfully restructure, it needed the CCAA court to stay the CTA from taking any action that could affect the airline's rights or require it to make financial investments in respect of complaints about its failure to comply with the *Canada Transportation Act* and associated regulations. The types of actions include those respecting complaints: about the accessibility of transportation services, including allergy- and oxygen-related complaints; concerning Air Canada's tariffs or its failure to comply with tariffs; related to pricing; and to the Office of the Air Travel Complaints Commissioner against Air Canada and its subsidiaries.

The Attorney General of Canada (on behalf of the CTA and other federal regulators) and the Federal Privacy Commissioner (collectively, the Federal Regulators) brought a motion claiming that the court had no jurisdiction under the CCAA to stay proceedings by any of the federal regulators who oversee Air Canada. However, the Federal Regulators did not seek alternate relief such as an order lifting the stay in the event that they were unsuccessful with their primary argument, which suggests that the objection may have been a matter of principle rather than to the practical effect of the stay.

The Federal Regulators argued that the interpretation of the word "proceedings" should be restricted to judicial or quasi-judicial proceedings involving creditors, such as court actions or arbitration proceedings, and should not include regulatory activities. However, the court did not agree with this position. Farley J. ruled that the word "proceedings" is not restricted to judicial and quasi-judicial proceedings because to allow non-judicial proceedings against a debtor could prejudice creditors and make an effective plan impossible. Farley J. noted that Parliament could have restricted the term when it drafted the legislation;

for example, it could have limited the application to "proceedings before a court or tribunal". He concluded that the fact that Parliament chose not to restrict the applicability of the stay provisions, even after two sets of extensive amendments to the CCAA, indicates that the word "proceedings" should be interpreted broadly. Farley J. also noted that the CCAA expressly exempts certain non-judicial government activities from being stayed and that such an exemption would be unnecessary if these activities could not already be stayed under the "proceedings" provision.[40] Finally, Farley J. decided that even if the CCAA did not provide the authority to stay regulatory proceedings, a CCAA court could do so through its inherent jurisdiction.[41]

Farley J. held that the CCAA authorized (or, alternatively, that the court had inherent jurisdiction to grant) a "temporal" stay of regulatory activities, proceedings, and enforcement.[42] The stay was issued based on Air Canada's evidence that dealing with regulatory matters beyond the four pillars of health, safety, security, and airworthiness would seriously impair the airline's restructuring efforts and ability to manage its ordinary course business operations. Air Canada had proposed that the Federal Regulators be authorized to engage in regulatory activities in respect of the four pillars, but that the enforcement of any decision in respect of these areas would be stayed. Farley J. accepted this proposal, but adjusted it to allow the Federal Regulators to enforce any regulatory order or equivalent in relation to the four pillars if the Federal Regulators deemed it appropriate in a particular situation based on "objective, justifiable grounds".[43] Farley J. appears to have been concerned that the Federal Regulators would interpret this exception too broadly and issued a caution regarding the "appropriate penalty" that would be levied against any Federal Regulator that unnecessarily or unreasonably enforced a decision while the stay was in place.[44]

2. — Effect of the Sanction Order

After emerging from court protection, Air Canada took the position that the Order approving Air Canada's Plan of Reorganization, Compromise and Arrangement (Sanction Order) extinguished CTA applications made pursuant to the *Canada Transportation Act* that related to events that occurred prior to the date of the AC Initial Order. The CTA brought a motion returnable March 1, 2005 for an order declaring that the Sanction Order did not extinguish such applications or otherwise affect regulatory matters arising prior to the date of the AC Initial Order. In particular, the CTA sought an order declaring that the Sanction Order did not affect: (i) the airline's obligation to comply with pre-filing orders or directions (even where such order or direction would have the effect of requiring the airline to spend money to comply); or (ii) enforcement or recovery actions for amounts owing to the Crown in respect of the airline's regulatory non-compliance. At the time of writing this paper, the motion had not been heard by the court.

3. — Effect of Chapter 47 on Regulatory Activity: The Pendulum Swings Too Far

Anecdotal evidence suggests that one of the key reasons for the success of many CCAA restructurings has been the flexibility afforded to the court under the CCAA. The CCAA has frequently been described as a "bare bones" statute; and in many ways that has been its greatest strength, particularly when combined with the skill with which the courts have generally exercised the broad jurisdiction conferred thereunder.

It is true that there are large gaps in the CCAA. There are several important issues, such as DIP financing and the treatment of collective agreements, that are not addressed in the current legislation. Yet, far from hampering restructuring efforts, the comparative uncertainty associated with litigating these "gap" issues has created an environment wherein the parties are motivated to reach consensual agreements. Parties have at times been "encouraged" to move from positions based on even the most closely held ideological principles by the potential consequences of unsuccessfully litigating these issues (particularly when the presiding Judge takes the opportunity to graphically describe these consequences in open court). The fact that CCAA reorganizations tend to be built on a framework of business agreements rather than court-imposed resolutions arguably leads to a stronger post-exit company.

Certainly, the CCAA does require some adjustment. However, any amendments to Canada's insolvency law regime should be made only following detailed consultation with the major stakeholders: the legal, financial, and corporate sectors. Unfortunately, in the period leading up to the end of the Liberal government led by Paul Martin, Parliament attempted to fast-track Chapter

47 into force. In the view of the authors, Chapter 47 achieves very little practical improvement, while causing significant impairment to Canada's restructuring law regime.

Chapter 47 contains a set of comprehensive changes to Canada's insolvency law regime. Chapter 47 purports to address a number of important issues, including the jurisdiction of the court to stay regulatory activity. Its introduction caused an uproar within the legal, financial, and corporate stakeholder groups due to the fundamental nature of the changes that the proposed legislation would have effected (many of which would have led to increased uncertainty and decreased flexibility in key areas such as re-financings and labour issues). The legislation has not yet been proclaimed, but a review of the provisions dealing with the jurisdiction of the court to stay regulatory activity is appropriate.

The effect of s. 11.1 of Chapter 47 would be to swing the pendulum too far in favour of the regulators, particularly with respect to restructurings of large companies. Pursuant to Chapter 47, regulatory authorities could be stayed under the CCAA from enforcing their rights as creditors of the debtor company, but not from enforcing their rights as regulators unless the court is convinced that the debtor company cannot make a viable proposal without the stay and that the stay is not against public interest. The proposed provision eliminates the need for regulators to negotiate with debtors toward the type of *modus vivendi* described by Farley J. in *Air Canada, Re*.

Section 11.02 of the proposed legislation contains a revised general stay provision, and s. 11.1 provides as follows:

> (1) Subject to subsection (3), no order made under section 11.02 affects the rights of a regulatory body with respect to any investigation in respect of the company or any action, suit or proceeding taken or to be taken by it against the company, except when it is seeking to enforce any of its rights as a secured creditor or an unsecured creditor.
>
> (2) If there is a dispute as to whether a regulatory body is seeking to enforce any of its rights as a secured creditor or an unsecured creditor, the court may, on application made by the company with notice given to the regulatory body, make an order declaring that the regulatory body is or would be so seeking to enforce its rights.
>
> (3) Subsection (1) does not apply in respect of any or all actions, suits or proceedings taken or to be taken by a regulatory body if the court, on application made by the company with notice given to the regulatory body, makes an order declaring that a viable compromise or arrangement could not be made in respect of the company if that subsection were to apply.
>
> (4) The court shall not make the declaration referred to in subsection (3) if it is of the opinion that it is in the public interest that the regulatory body not be affected by the order made under section 11.02.
>
> (5) In this section, "regulatory body" means any person or body who has powers, duties or functions relating to the enforcement or administration of any Act of Parliament or of the legislature of a province and includes any person or body prescribed to be a regulatory body for the purpose of this Act.

Section 11.1 would place a heavy onus on the debtor company. Under the proposed amendment, a regulatory body would continue its ordinary course regulatory activities unless the debtor company can convince the court that a viable compromise or arrangement could not be made in respect of the company unless the regulator is stayed. It may not be possible for a debtor company to establish that any particular regulatory proceeding would be fatal to its restructuring efforts; death by a thousand paper cuts is still death, even if no single paper cut would have by itself been fatal.

If the purpose of the CCAA stay provisions is to provide debtors with "breathing room" within which to negotiate arrangements with their creditors, then the stay should apply equally to non-four pillar regulators. It makes no difference to a restructuring company whether management's attention is unnecessarily diverted by lawsuits from creditors or by administrative proceedings by regulators; the point is that in either circumstance management's attention is *not* devoted to survival through a restructuring, at a time when management's attention is most critical.

As noted earlier, there are few industries as heavily regulated as air transport, and everyone would agree that air transport regulation in respect of the four pillars should not be affected by the CCAA. But at the time of filing Air Canada was faced with a barrage of regulatory activity, including proceedings by such decidedly non-four pillar regulators as the Commissioner of Official Languages. It is difficult to see what benefit would come from diverting management's attention from a restructuring to address these types of issues. Likewise, it is difficult to see what prejudice a regulator would sustain if it were subject to a "temporal" stay of the kind imposed by Farley J. In any event, it is always open to a regulator who is particularly aggrieved by the stay to bring a motion to have it lifted.

V. — The Ongoing Saga of Set-Off under the CCAA

1. — The Law of Set-Off Generally

There are three types of set-off: legal, equitable, and contractual/statutory.

Legal set-off requires liquidated claims between the same two parties. Equitable set-off is available where there is a claim between two parties for a sum whether liquidated or unliquidated if the following tests are met:

(a) the party relying on a set-off must show some equitable ground for being protected against the adversary's demands;

(b) the equitable ground must go to the very root of the plaintiff's claim;

(c) a cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross-claim;

(d) the plaintiff's claim and the cross-claim need not arise out of the same contract; and

(e) unliquidated claims are on the same footing as liquidated claims. [45]

2. — Set-Off in Canadian Insolvency Proceedings

The law of set-off is expressly preserved in proceedings under the BIA by s. 97(3) of the BIA. It provides as follows:

> (3) Law of set-off or compensation — The law of set-off or compensation applies to all claims made against the estate of the bankrupt and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were a plaintiff or defendant, as the case may be, except so far as any claim for set-off or compensation is affected by the provisions of this Act respecting frauds or fraudulent preferences.

The law of set-off is expressly preserved by s. 73 of the *Winding-up and Restructuring Act* [46] (WURA). It reads as follows:

> 73. (1) Law of set-off to apply — The law of set-off, as administered by the courts, whether of law or equity, applies to all claims on the estate of a company, and to all proceedings for the recovery of debts due or accruing due to a company at the commencement of the winding-up of the company, in the same manner and to the same extent as if the business of the company was not being wound-up under this Act.

Legal and equitable set-off are available for claims existing as at the date of the bankruptcy or as at the date of the winding-up, as the case may be. However, a claim arising after the date of bankruptcy or the date of the commencement of the winding-up cannot be set off against a claim that arose prior to the date of bankruptcy or the commencement of the winding-up. The courts have held that there is no mutuality once a bankruptcy has occurred or a liquidation has commenced. The trustee in bankruptcy is not the same person as the bankrupt, nor is the liquidator the same person as the company now in liquidation.

Prior to the 1997 amendments to the CCAA, the Act was silent as to set-off rights. Counsel for applicants under the CCAA inserted provisions in initial orders restraining creditors from exercising rights of set-off. They did so in reliance upon the then s. 11 of the CCAA, which conferred jurisdiction upon the court to make an order restraining any "action, suit or proceeding" against the applicant.

The issue of whether the court had jurisdiction under that provision to restrain rights of set-off was widely debated. The issue was thought to have been put to rest in 1997.

3. — The 1997 Amendments

One of the amendments to the CCAA made in 1997 expressly preserved set-off rights. Section 18.1 of the CCAA provides as follows:

> 18.1 Law of set-off or compensation to apply — The law of set-off or compensation applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

This is virtually the same language as is contained in subs. 97(3) of the BIA. However, s. 73 of the WURA refers to "all claims" and "all proceedings for the recovery of debts due or accruing due" as "*at the commencement of the winding-up*"(emphasis added).

The caselaw following the 1997 amendments appears to be clear that legal and equitable set-off are available for claims both of which existed as at the date of an initial order and that legal and equitable set-off are available for claims both of which arose after the date of an initial order.

The AC Initial Order contained the following provision dealing with set-off:

> 9. THIS COURT ORDERS that persons may only exercise such rights of set-off as are permitted under Section 18.1 of the CCAA as of the date of this Order. For greater certainty, no person may set off any obligations of an Applicant to such person which arose prior to such date.

Air Canada was indebted to certain parties as at the date of the Initial Order. Subsequent to the date of the Initial Order, those parties became indebted to Air Canada. They wished to set-off their post-CCAA debts against Air Canada's pre-CCAA debts owing to them. In order to do so, they moved to vary the AC Initial Order such that it would provide as follows:

> 9. THIS COURT ORDERS that persons may only exercise such rights of set-off as are permitted under Section 18.1 of the CCAA.

Air Canada took the position that legal set-off was not available in respect of a pre-CCAA debt and a post-CCAA debt. Air Canada argued that the making of an initial order under the CCAA severed the requisite mutuality and that a CCAA applicant is a separate legal entity from the corporation prior to the making of the initial order.

Farley J. carefully reviewed the caselaw dealing with set-off rights in a bankruptcy and in a winding-up.[47] He noted that, in a bankruptcy, title to the assets of the bankrupt vests in the trustee. Accordingly, mutuality is lost. While there is no vesting in a winding-up, the liquidator is appointed for the purpose of liquidating the business. As a result, the caselaw is clear and consistent that there is a loss of mutuality in a liquidation because the liquidator acts for the creditors — not for the shareholders. Farley J. distinguished a restructuring under the CCAA from a bankruptcy or a winding-up because the applicant remains in possession and control of its property and continues to carry on business while it seeks to restructure its affairs. He also pointed out the difference in the wording of s. 18.1 of the CCAA, which is silent as to the timing of the cross-claims, and s. 73 of the WURA, which refers to cross-claims in existence as at the commencement of the winding-up. Farley J. held that there was no loss of mutuality upon the commencement of a CCAA proceeding. Accordingly, legal set-off is available both in respect of debts existing as at the date of an initial order and in respect of debts that arose after the date of an initial order. Farley J. was correct in so doing.

Air Canada did not argue that equitable set-off was not available in respect of a pre-CCAA claim and a post-CCAA claim. Given that mutuality is also required for equitable set-off, it is somewhat surprising that Air Canada did not take the same position in respect of equitable set-off as it took in respect of legal set-off. Farley J. made the amendments requested by the moving parties to the AC Initial Order. Air Canada took the position that, while equitable set-off was available in respect of pre-CCAA and post-CCAA claims, the court ought to issue a temporal stay. Air Canada requested that the determination of whether equitable set-off was available ought to be postponed until such time as the CCAA proceeding was stabilized. The moving parties did not oppose granting of such a temporal stay. Farley J. made that temporal stay order. [48]

The authors are of the view that the court has jurisdiction to determine when rights will be exercised in a CCAA proceeding. While there has been great debate over the nature and extent of the inherent and statutory jurisdiction of the CCAA court, there is no question that the court has the inherent jurisdiction to control its own process. As a result, the court was within its jurisdiction to issue such a temporal stay.

4. — Summary

It now appears to be clear in Canada that legal and equitable set-off are unaffected by proceedings commenced under the CCAA other than (i) the right to exercise them may be "temporally" stayed and (ii) if the CCAA applicant refuses to acknowledge the set-off, it would be necessary for the creditor to seek judicial intervention.

It is the authors' view that it is appropriate for set-off rights to continue after the commencement of a CCAA proceeding. The CCAA applicant continues to carry on business in the ordinary course. If it wishes to continue to have the benefit of its contacts and other business relationships, it ought to be subject to the burdens of those contacts and relationships. This leaves open the possibility that post-filing account debtors to a company in a restructuring may seek to purchase debt claims of creditors of the insolvent company (at a discount) to avoid making payments under its contracts with the CCAA debtor by claiming legal set-off. This practical point was strenuously argued by Air Canada. In the authors' experience, this theoretical possibility has not yet emerged as a significant issue in practice. If and when it does emerge as a significant problem, a statutory amendment may be required to solve it.

VI. — The Role of the Monitor

The appointment of a Monitor during a CCAA proceeding has only been mandatory since 1997. As a result, the role of the Monitor in a CCAA proceeding is continuing to evolve to meet the challenges faced in particular proceedings. This ever-evolving role is illustrated in the restructuring of both Air Canada and Stelco. The role of the Monitor is enunciated in s. 11.7(3) of the CCAA, which provides as follows:

> (3) The Monitor shall:
>
> > **(a)** for the purposes of monitoring the company's business and financial affairs, have access to and examine the company's property, including the premises, books, records, data, including data in electronic form, and other financial documents of the company to the extent necessary to adequately assess the company's business and financial affairs;
> >
> > **(b)** file a report with the court on the state of the company's business and financial affairs, containing prescribed information,
> >
> > > **(i)** forthwith after ascertaining any material adverse change in the company's projected cash-flow or financial circumstances,
> > >
> > > **(ii)** at least seven days before any meeting of creditors under section 4 or 5, or

(iii) at such other times as the court may order;

(c) advise the creditors of the filing of the report referred to in paragraph (b) in any notice of a meeting of creditors referred to in section 4 or 5; and

(d) carry out such other functions in relation to the company as the court may direct.

The broad discretion granted to the court under s. 11.7(3)(d) allows the court to tailor the role of the Monitor to the circumstances that present themselves in a particular restructuring. As a court-appointed officer, the Monitor has an overriding duty to the court and to the stakeholders as a whole in fulfilling its mandate. This duty extends not only to creditors of the debtor company but also to shareholders, employees, and the public interest. Fulfilling the Monitor's duties can be extremely difficult given that often stakeholders have divergent views on any given issue.

1. — Air Canada

During the *Air Canada* proceeding, the Initial Order contemplated the Monitor fulfilling a traditional monitoring role. This included assisting the company in respect of its cash flow projections, assisting with the negotiations with creditors, reporting to the court, and providing the court with its independent views of the relief sought by the company throughout the proceeding. [49]

After 13 months under CCAA protection, the putative plan sponsor, Trinity Time Investments Inc. (Trinity), advised that it was not prepared to extend its financing agreement to allow Air Canada to put forward a plan of arrangement or compromise to its creditors. Air Canada's chief restructuring officer promptly resigned. Air Canada's credibility with the stakeholders was compromised, and its ability to conclude the restructuring was questioned. The company decided that the Monitor, as an independent court officer, should be given a greater role in the restructuring process to maintain credibility with stakeholders moving forward. As a result, the court expanded the role of the Monitor and approved an equity solicitation process to be supervised directly by the Monitor. The parties referred to the Monitor with such expanded powers as the "Über-Monitor". The Order of Farley J. dated May 4, 2004, directed the Monitor to take on the following expanded role:

> [To] supervise, facilitate and oversee the financial restructuring of the Applicants, which shall include directing the development and implementation of a corporate governance structure, working in coordination with Air Canada, and consulting to the extent reasonably possible with Air Canada's stakeholders. [50]

From this point forward, the Monitor supervised the process, which eventually resulted in Cerberus Capital Management, L.P. (Cerberus) becoming the plan sponsor for Air Canada. Cerberus emerged as the winner of a competitive and litigious process between competing sponsors. The Monitor played an active role in monitoring and supervising the negotiations that became necessary to create and implement the plan. The Monitor played a pivotal role in fulfilling its enhanced duties through the final months of Air Canada's restructuring.

2. — Stelco

The powers and duties of the Monitor set out in para. 58 of the Stelco Initial Order were drafted to allow flexibility as to the role the Monitor would play in the proceeding by providing that the Monitor would "advise and assist to the extent required by Stelco". [51] The Stelco Initial Order also appointed a chief restructuring officer (CRO) to assist Stelco. In addition, Stelco retained two financial advisors during its CCAA Proceeding.

In the Stelco restructuring, the Monitor initially assumed the traditional role similar to that in Air Canada. Its role evolved, as in Air Canada, and included the Monitor playing an important role in the protocols, which were eventually developed between the company and its unions regarding negotiations in respect of the sale of subsidiaries as part of the restructuring process.

Like Air Canada, Stelco also suffered from adverse developments during the restructuring process. The initial process to find investors or purchasers (the "stalking horse" process) did not attract a successful bidder. The company's efforts to take advantage of high steel prices and periods of profitability to find a capital markets solution also did not meet with success. However, although informally suggested by most major stakeholders at one point or another, the role of the Monitor did not transform into the expanded role that occurred in the *Air Canada* case. The Stelco restructuring team, including its chief restructuring officer and its hands-on chief executive officer, remained in control of the restructuring process. The Monitor remained merely an active facilitator of the negotiations undertaken among the various stakeholders and Stelco, rather than a commercial driver of the result.

There are several examples throughout the restructuring process of the Monitor's active facilitator role. Firstly, the Monitor participated in discussions between potential bidders and the unions after Farley J. approved the stalking horse process discussed above. The terms of the sales process were heavily negotiated between Stelco and its stakeholders, with input from the Monitor. Ultimately, the union agreed to allow the Monitor to attend all meetings and discussions with potential bidders, and Stelco agreed to allow potential bidders to meet with the unions in the presence of the Monitor. Secondly, after the sales process failed to result in an acceptable bid for Stelco (it should be noted that sales process resulted in the sale of other Applicants and certain of their non-Applicant subsidiaries), the Monitor coordinated two mediations among Stelco and its stakeholders and assisted the court-appointed mediator, the Honourable Mr. Adams, throughout the mediations. The Monitor participated with the mediator in around-the-clock mediations and was active in attempting to bridge the gaps between the fractioned interests. The Monitor continued its diplomatic interventions in yet another round of negotiations that ultimately resulted in agreements being reached between Stelco and U.S.W., Local 8782, the Province of Ontario (the Province) and the union-supported exit financier/plan sponsor, Tricap Management Limited (Tricap). These agreements formed the backbone of the successful restructuring plan for Stelco.

3. — Changes to the Role of the Monitor under Chapter 47

The authors are of the opinion that the duties and functions of the Monitor set out in Chapter 47 (s. 23(1)(a) to (k)) [52] are simply a recognition of the role the Monitor was always able to play under s. 11.7(3)(d) of the CCAA if necessary or appropriate in the circumstances. The authors caution against reading these amendments (if they come into force) as somehow detracting from the ability of the Monitor to expand its role to meet the circumstances of a particular proceeding as it is the flexible nature of the role that makes the Monitor an invaluable and necessary asset to any successful complex restructuring.

The role of the Monitor has stimulated much debate, particularly as to whether the role of the Monitor should be "skinny", limited to a mere watchdog or whistleblower position, or whether the role should be more expansive, such as the "Über Monitor" role performed in *Air Canada*. Again, the authors promote flexibility. In some cases, and at some times, the Monitor's role can and should be limited. In other cases, and at other times, the Monitor's role can and should expand to maximize the chances for a successful restructuring. As occurred in both the *Stelco* and *Air Canada* cases, it is suggested that the role of the Monitor should begin by giving the Monitor the traditional roles of assisting in the dissemination of information, reporting to the court, assisting in the creation of and negotiations relating to the development of a plan, and playing a significant role in the administration of the claims adjudication process. Throughout the course of the proceedings, the role of the Monitor should expand or contract as requested by the stakeholders and the debtor company, as thought appropriate by the supervising judge.

The authors also wish to add a thought about the role of the Monitor and conflicts. It should be recognized by all participants in the restructuring process that the Monitor is mired in conflict at all times during a CCAA restructuring since it has the irreconcilable duties of representing the interests of all stakeholders when such interests are inevitably, and often dramatically, adverse. In addition, the Monitor is usually mandated to assist the debtor company in a number of ways that further puts it at odds with its duties as a creditor representative. Finally, and most importantly, the Monitor is an independent officer of the court and therefore must perform all of these roles while retaining its independence and integrity.

Given these conflicting duties, it is inappropriate to judge Monitors by the standards of conflict of interest that have developed in respect of representation by legal counsel and in respect of persons who hold fiduciary duties to others. Monitors cannot be held to the same standard because the role that they perform pushes them into situations where decisions have to be made on a daily basis that adversely, and sometimes materially, affect the interests of a particular stakeholder, stakeholder group, or the debtor company. To hold otherwise would sideline the Monitor from a necessary function that it must serve, which is to be able to independently advise the debtor company, the stakeholders, and the court of its view of particular courses of action and decisions made or contemplated. In particular, the court is entitled to expect the Monitor to present its independent assessment of difficult, complicated, and often highly nuanced issues that come before the court in the course of any large restructuring. To attempt to hold the Monitor mute in such circumstances would be to deprive the court of an important voice in the restructuring process.

VII. — Strategies for Dealing with Major Stakeholders

Restructurings of large corporations are chaotic events. After the dust settles, and with the benefit of hindsight, participants will declare ingenious strategies to have been employed when in fact there were none and, in other cases, strategies will have been implemented so deftly that the participants never suspected that the result was crafted by design rather than natural circumstances. As usual, the truth lies somewhere in the middle. Given the frenzied nature of the day-to-day activity in a major restructuring, it is often difficult, even with hindsight, to determine whether any particular strategy was being implemented by the debtor, a stakeholder or a stakeholder group. Daily crisis management, often including survival tactics, regularly obscures strategic vision. More colourfully put: “When you’re up to your waist in alligators, it is difficult to remember that the goal was to drain the swamp.”

However, it is instructive to review the Air Canada and Stelco restructurings to determine if insights can be gleaned into what worked and what did not.

For the purpose of this analysis, we will simplify the number of parties involved for the sake of brevity and clarity. Although the omitted parties all played important roles, they are not necessary for the purpose of this illustration, and the authors apologize in advance should anyone feel offended. If this apology is insufficient, then suffice it to say that the authors are unwilling to let all of the facts get in the way of a good story.

Restructuring	**Key Participants**	
—		
Air Canada	(i)	unions;
	(ii)	exit financier and major lessor;
	(iii)	other lessors;
	(iv)	proposed plan sponsors (2); and
	(v)	federal government.
—		
Stelco	(i)	unions;
	(ii)	exit financier and plan sponsor;
	(iii)	bond holders;
	(iv)	other plan sponsors; and
	(v)	provincial government.

Assessing the facts and timeline as they occurred in both restructurings, and without ascribing any credit or blame with respect to strategic or tactical intent on the part of any participant, the Air Canada restructuring proceeded in a linear fashion involving a succession of bilateral negotiated arrangements with stakeholders in the following sequence of events:

(1) Deal with unions for concessions.

(2) Deal with exit financier and major lessor for restructured leases of one-third of the fleet, exit financing and financing of new regional jets as part of a restructured Air Canada business plan.

(3) Deals with other lessors for remaining fleet requirements.

(4) Deal with initial plan sponsor.

(5) Rejection of initial plan sponsor by some stakeholders.

(6) Deal with new plan sponsor.

(7) Deal with unions regarding additional concessions required by second plan sponsor.

(8) Deal with government regarding revised pension regulation requirements.

(9) Successful exit.

The Stelco path began as a series of negotiations with multiple stakeholder groups and only became linear near the end, as follows: [53]

(1) Legal battles with unions regarding the non-applicability of the CCAA process.

(2) Negotiations with stakeholders, particularly unions and bondholders, regarding stalking horse bidding process seeking sale or recapitalization of Stelco (failed).

(3) Mediation by third party mediator involving unions, government, exit financier and plan sponsor and Stelco (failed).

(4) Second meditation with third party mediator involving unions, government, exit financier and plan sponsor and Stelco (failed).

(5) Deal with unions regarding collective agreements.

(6) Deal with government regarding pension contributions and funding.

(7) Deal with exit financier and plan sponsor.

(8) Further deal with additional plan sponsors.

(9) Deal with sufficient majority of bondholders to pass vote.

(10) Successful exit.

While it would be dangerous to extrapolate too much from these simplified examples, there are observations that can be made that are instructive.

The first of these is that group negotiation is more difficult, and therefore less likely to be successful, than bilateral negotiation. This conclusion is neither remarkable nor surprising. Adding more stakeholders to a negotiating mix, particularly where their respective interests are divergent (as opposed to convergent or even somewhat aligned) creates multi-dimensional negotiating conditions not present in one-on-one negotiations. It also increases the likelihood that true bargaining will be overshadowed by negotiation posturing.

As a second observation, the authors note that “restructuring momentum” is a factor. In multi-party negotiations, there are, at least, two pressures continually at work:

(1) a positive pressure whereby each stakeholder attempts to move the debtor and the other stakeholders toward its position; and

(2) a negative pressure, which is the desire by each stakeholder to keep the debtor from agreeing to terms with other stakeholders that are seen as adverse to the interests of the first stakeholder.

Debtors often describe their position in the middle of these tensions as “the meat in the sandwich”. This might be an accurate representation when two stakeholders are involved, but it fails to capture the three-dimensional essence of multi-party negotiations. Each stakeholder attempts to both bring the debtor to its position and simultaneously keep the debtor away from the other stakeholders' positions.

In this circular (really, spherical) negotiating dynamic, directed motion towards any particular goal is difficult. Debtors complain, as Stelco did, that they seem to be "going in circles" at this point in the process. In the authors' view, this is an accurate assessment. It is a separate question as to whether or not "circular negotiation" is necessary, such as in Stelco's case, to lay the ground work for the final decisions that allow the company to complete negotiations with first one party, then a series of other stakeholders, eventually leading to a successful restructuring. Post-mortem analysis on the appropriateness, necessity, or extent of multi-party negotiation in any particular situation is little more than speculation.

The key common element is that both corporations started on the road to a successful restructuring once the debtor finalized agreements with one major stakeholder in bilateral negotiations and not through multi-party negotiations. The authors suggest that "doing a deal" with one major stakeholder or group of stakeholders begins to create momentum in favour of a successful restructuring by eliminating some of the negative negotiating pressure that exists in the circular/spherical model. When a deal is reached with one stakeholder, the other stakeholders realize that it will be difficult to break or prevent that deal from forming part of the restructuring, and their energy becomes focused in bringing the debtor as close as possible to their preferred position whilerecognizing they may not be able to achieve everything they desired. The other shareholders sense that "the train is about to leave the station" and recognize their need to get on board. As more business deals are negotiated, the manoeuvring room for the remaining stakeholders dwindles, and ultimately the last of the stakeholders finds relatively little negotiating room or, in the common parlance, the last holdouts are "run over" by the process.

This analysis suggests that those who make arrangements with the debtor earlier in the restructuring process are treated better than the holdouts and, in many cases, this has been true. However, real world negotiating dynamics do not always obey theoretical models. Outcomes in any CCAA restructuring process still are determined more by the will of the participants and their respective negotiating leverage than any theory of negotiation. Furthermore, as a cautionary tale, it should be noted that the unions in Air Canada, for example, were among the first to make arrangements with the company only to find themselves subject to further concessions dictated by later participants in the restructuring that enjoyed greater negotiating leverage.

To summarize, multi-party discussions and negotiations may be necessary so that the participants can understand the concerns, negotiating positions, and leverage held by all of the parties. However, momentum for a restructuring only starts when a deal is made with one stakeholder or stakeholder group and it increases as more deals begin to cluster around the first. The catalytic consequences that flow from the first stakeholder deal generate the "restructuring momentum", which is an important element to recognize in the CCAA restructuring process.

It takes both a strong will and significant negotiating leverage to derail a restructuring once it garners the support of several critical stakeholder groups. Parties attempting to do so should steel themselves for the battle of wills that will ensue as well as the delays that will be caused. They must also have a clear understanding of their negotiating leverage, how it will be exercised, and where they are vulnerable. Near the end of a restructuring process, "deal fatigue" is a major contributing factor as the final participants often seek merely to end the process rather than start fighting fresh battles for that final concession or additional consideration. Reluctant acceptance of a "considerably less than ideal" plan at the end of a long, hard-fought restructuring is not uncommon.

By way of specific example, in the Stelco situation, the bondholders committee controlled sufficient votes to veto any plan of reorganization put forward by Stelco. The Stelco plan, as discussed above, eventually evolved out of an arrangement first with the unions and shortly thereafter the Province and the union-supported exit financier/plan sponsor, Tricap. The bondholders were the last holdout. The plans presented to the often-adjourned meetings of creditors were negotiated, amended and supplemented bit by bit, up until the final moments before the eventual vote. Finally, a sufficiently large majority of the bondholders was not prepared to veto the plan but rather to accept it. It was, perhaps, not so much an outcome that the bondholders desired, but one that they ultimately resigned to accept in the face of the momentum for the restructuring built by the company and the other stakeholders.

In summary, the restructurings of Air Canada and Stelco offer some interesting insights into the benefits of creating "restructuring momentum" by entering bilateral agreements with major stakeholders rather than attempting to settle all issues in multi-party negotiations. Furthermore, restructuring momentum and deal fatigue often combine to make the last participants in a restructuring the least satisfied with the outcome.

VIII. — Dealing with Unions

1. — Understanding the Labour Movement

Appreciating the history and evolution of the labour movement in North America is fundamental to understanding the tensions in play when dealing with unions, particularly with respect to negotiations in a restructuring context. The labour movement had a violent and bloody history, in which the concessions and rights that many now take for granted were earned at great cost and in circumstances where workers felt betrayed by big business, the government, and the judicial system. The creation of specialized labour relations tribunals is a direct consequence of the history of the labour movement and the recognition that special skills are needed to supervise and adjudicate the employer-union bargaining dynamic.

In light of its history, significant elements of organized labour today remain mistrustful of the judicial system. Unions are primarily of the view that negotiations between an employer and its organized workers ought to be conducted within the ambit of the collective agreement and the collective bargaining structure, including dispute resolution and adjudication under the auspices of the labour boards rather than the courts. Unions often take the position that the institution of insolvency proceedings should not alter the obligation of an employer to negotiate with its organized employees through the collective bargaining mechanism. When viewed in its historical context, the unions' reluctance to be dragged into the CCAA restructuring process in the *Stelco* case is understood readily.

The mistrust shown by the labour movement of the judicial system has been heightened in the United States due to the provisions of the U.S. *Bankruptcy Code*, which permit an employer under Chapter 11 to disclaim collective agreements where the employer can show it is necessary for the restructuring. [54] In addition, in Chapter 11 cases, the court may approve terms of a new collective agreement in certain circumstances. The unions consider these provisions to be a fundamental abrogation of the collective bargaining system instituted by U.S. Congress in the 1930s.

The law in Canada is less clear. The *Mine Jeffrey* [55] case has been interpreted by some to mean that a collective agreement cannot be repudiated under the CCAA although this may be overstating the holding of that peculiar case. In the authors' view, *Mine Jeffrey* should be restricted to its particular facts. It is true, however, that no Canadian court has imposed a new collective agreement between a debtor company and its union under the CCAA, although the threat of such an eventuality has resulted in negotiated deals as part of the overall restructuring process.

Chapter 47 clarifies the situation in Canada and in so doing eliminates some of the leverage that debtor companies now enjoy. Under s. 32 of the CCAA, as it will be amended if Chapter 47 is proclaimed in force, a collective agreement is not an agreement that a CCAA debtor may disclaim or resiliate. Furthermore, under s. 33 of the CCAA as it is proposed to be amended, the power of the court is limited to allowing the debtor company to serve a notice to bargain, thereby effectively determining that the court does not have the power to unilaterally impose new terms of a collective agreement.

While Chapter 47 has not yet been proclaimed, Canadian courts will be reluctant to allow debtors to unilaterally repudiate collective agreements and will be equally reluctant to impose revised terms in light of the passed but not proclaimed status of Chapter 47.

With this background, the particular circumstances of the Air Canada and Stelco restructurings in regard to their dealings with their respective unions are examined in detail below.

2. — Background of the Cases

Both Air Canada and Stelco cited pension solvency deficiencies and uncompetitive labour costs as important factors contributing to the need for a financial and operational restructuring of the companies.

Robert Peterson, on behalf of Air Canada, stated that “no amount of balance sheet restructuring alone [would] make Air Canada a viable airline given its current labour cost structure” [56] and further noted that “[t]he first and most critical component of a successful restructuring is matching our labour costs and productivity to the post-restructuring business model and the economic imperatives of the market place”. [57] Air Canada also indicated that it would require approximately $650 million of annual savings from its various labour groups through a combination of measures, including productivity improvements and wage reductions. [58]

Stelco cited intense competition in the steel industry and competitive cost disadvantages, including high cash funding costs for pension plans and other employment benefit plans, as one of the main causes of its financial difficulty. [59]

In the *Air Canada* case, the major unions went through, not one, but two rounds of negotiated wage, benefit, workplace rule, and other concessions causing them to be significant financial contributors to the restructuring. The pension shortfall was allowed to be paid over 10 years rather than five (with no significant initial payment). In the Stelco restructuring, on the other hand, one major union local effectively withdrew from the restructuring for most purposes with no change to its collective agreement while the other major union local signed a new collective agreement with wage increases rather than cut-backs and a signing bonus of approximately $3,000 per employee. In addition, the union introduced the successful exit financier, Tricap, into the transaction. The union had significant influence in the sale of various Stelco subsidiaries, and the pension plans received a $400-million cash contribution upon the closing of the restructuring. Along the way, the unions were described by the court as having a “functional veto” over the restructuring process.

Why did the results of the restructurings in respect of labour and pensions vary so dramatically between the two restructurings and what does this mean for the future of labour involvement in large Canadian corporate restructurings?

We will deal first with an analysis of the two restructurings and then offer reflections on the implications for the future.

3. — Air Canada

Air Canada was in a full-blown, genuine financial crisis at the time of its initial filing and thereafter. The airline could not sustain operations with the cash “burn rate” of approximately $2 million per day. Of even greater significance from the perspective of labour, if the restructuring failed, there was no guarantee that all, or even most, of the parts of the Air Canada business enterprise would have been purchased on a going concern basis such that jobs would be preserved through a successor employer. Unlike a typical manufacturing business, an airline does not have a central facility where its product is made that, if bought and continued as a going concern, would ensure that a significant portion of the jobs would likely be preserved. On the contrary, Air Canada is primarily a service provider in a competitive marketplace whose services could be replaced in a variety of ways, including increased flights and routes by existing competitors and/or by the creation of new airlines, for example local regional airlines, to replace routes flown by Air Canada. Furthermore, it was by no means certain, and in fact may not have been the case, that Air Canada assets would be used or purchased by the new service providers such that the new players might be held to be successor employers bound to Air Canada’s collective agreements. Aircraft could have been provided from non-Air Canada sources, as the downturn in the industry generally had resulted in a glut of aircraft in North America and elsewhere.

In summary, in the Air Canada situation, the alternative to a successful restructuring was uncertain. This fact, coupled with the fact that the *status quo* was not sustainable, introduced a considerable degree of risk into the negotiating dynamic from a labour perspective. The unions involved could not assure themselves or their members that Air Canada as a whole, or even significant portions of it, would exist in recognizable form after a failed restructuring. This is particularly true when viewed in the context of the uncertainty surrounding the airline industry generally at that time, including the ongoing effects of September 11, 2001, the effects of the outbreak of war in Iraq and the possibility that the SARS outbreak in Toronto and China could develop into a wider disaster, possibly even a pandemic. Extensive, permanent job losses were a significant risk of a failed restructuring.

Another factor that weakened the negotiating position of labour in the Air Canada situation was the fact that a successful outcome of the restructuring depended in part upon parties that were largely disinterested in the bilateral employer-union bargaining result. For example, it would have been difficult, and likely impossible, for Air Canada to have exited from the restructuring successfully if the lessors, which contributed the vast majority of aircraft to the Air Canada fleet, decided that there were better opportunities elsewhere (although in the prevailing conditions, this may not have been likely). This, in turn, depended upon market conditions for aircraft leases generally and the assessment of Air Canada as an ongoing credit risk. The last point was only tangentially influenced by the labour bargaining outcome. In short, if the lessors had decided to pull aircraft out of Air Canada's fleet by virtue of factors beyond the control of Air Canada and its unions, it would have potentially hurled Air Canada, and all its stakeholders, into a downward spiral toward an uncertain outcome.

A further factor involved was that large airlines in the U.S. either had undergone or were undergoing similar restructurings. In almost all cases, significant concessions had been obtained from labour, creating a strong initial impression that there was a commercial, competitive necessity for such concessions in the *Air Canada* case. The U.S. restructurings informed the reasonable expectations of the Air Canada stakeholders to the point where most participants felt that significant labour concessions at Air Canada were both necessary and inevitable.

In the result, the major Air Canada unions agreed to a series of compromises of significant value in a round of negotiations ultimately mediated, at the direction of Farley J., by the Honourable Mr. Justice Winkler. These agreements allowed Air Canada to present a business plan based, in part, upon these concessions to potential plan sponsors and ultimately led to a bid by Trinity, controlled by Hong Kong entrepreneur and Canadian citizen, Victor Li, to be the plan sponsor. However, Trinity required a further concession in respect of the pension plans as a condition of its deal. Specifically, it was proposed that post-exit new hires be granted an option as to whether to retain the defined benefit pension plans then in existence (funded in accordance with the plan) or to receive a newly created defined contribution plan.

After reaching their previous accords with Air Canada that did not include such an additional concession, the unions, predictably, reacted negatively to this suggestion. They rejected it as a matter of principle on the grounds that it could, in practice, lead to conflicting interests in the bargaining groups that, one suspects, might have been exploited by the new owners in future rounds of bargaining. In the result, the Trinity bid expired and the Air Canada restructuring was dealt a serious blow. Eventually, a new plan sponsor, Cerberus, was found. While not touching the sensitive issue of the defined benefit/ defined contribution pension scheme, Cerberus required further economic concessions from labour as a pre-condition of its financing and support. Again, predictably, the unions reacted negatively, not wanting to participate in a second round of "hair cuts". Mr. Justice Winkler was called upon again as mediator, and the restructuring of the company very much hung in the balance. Ultimately, a further agreement was struck that was satisfactory to the unions, Air Canada, and the plan sponsor, which involved further concessions but with the result that Air Canada was successfully restructured and many jobs and pensions were saved.

4. — Stelco

The circumstances for Stelco were considerably different. As stated above, at the time of its filing, Stelco, although in declining financial health, had more of an anticipated financial crisis, whereas Air Canada had an actual one. Moreover, the anticipated financial crisis did not materialize. Instead, Stelco enjoyed many quarters of significant, and at times record-breaking, net earnings after filing for protection. This fact, more than any other, effectively eliminated the ability of management to credibly insist on labour or pension concessions as a necessary pre-condition to any restructuring.

Furthermore, the nature of Stelco's operations contributed to different negotiating leverage than in the *Air Canada* case. The majority of Stelco's operations were at two plants. The Lake Erie facility was one of the newest steelmaking plants in North America, with significant productivity and cost efficiencies when compared to other North American plants. The other major facility was the Hamilton plant that was, by contrast, one of the oldest facilities, with relatively low productivity, a large workforce, and a large compliment of pensioners that accounted for the lion's share of the enormous pension deficit. The collective agreement for the Lake Erie plant expired during the course of Stelco's proceeding. The collective agreement for the Hamilton plant did not expire until months after the proceeding eventually ended. Unlike the Air Canada situation, the parties were reasonably certain that, in the event the Stelco restructuring was unsuccessful, there would be a going concern sale of the Lake Erie plant, at least. The Lake Erie U.S.W., Local 8782, and its bargaining partner, the U.S.W. International, knew with a significant degree of certainty that the Lake Erie plant, the "crown jewel" of Stelco, would continue in operations even if Stelco became bankrupt. A successor/purchaser was likely to have better long-term prospects than Stelco, at least in its then current financial condition. Although any purchaser might have insisted on labour concessions, there was no credible threat of a fundamental change (i.e., enormous loss of jobs) in respect of the Lake Erie plant. Even if labour concessions were to be sought by a purchaser, the unions appear to have concluded it would be better to wait and negotiate those concessions with the ultimate purchaser, if any, rather than negotiate one round of concessions with the company and a further round with the purchaser. In this regard, it may be assumed that the Stelco unions were mindful of what had recently transpired in Air Canada. The U.S.W. was not eager to take even one trip to the barber, much less two.

The Lake Erie Local continued working notwithstanding that its collective agreement had expired and in so doing extracted maximum leverage in the restructuring process. On the facts of the Stelco restructuring, it was likely that no investor or purchaser would commit to the financing or investment necessary to restructure or buy the Lake Erie facility without the certainty of labour peace including ascertainable terms of a new collective agreement. The importance of this ongoing leverage was highlighted by the fact that, even after the terms of the collective agreement were concluded, the Local delayed seeking formal ratification from its membership until such time as it was reasonably satisfied that all of the other pieces of the Stelco restructuring either had fallen, or were about to fall, into place. Had the agreement been ratified earlier, the collective agreement would have been implemented and their negotiating leverage would be lost or significantly weakened.

The practical effect of an uncertain labour environment was recognized by Farley J. as a "functional veto" [60] because of the practical implication that the financing necessary to achieve a successful restructuring would not likely be available to Stelco unless labour peace, at least at the Lake Erie plant, was assured for a reasonable period of time. Specifically, in approving a stalking horse proposal by Deutsche Bank under which the company sought investors, Farley J. stated: "The union would appear to have a functional veto if push comes to shove. I also assume that the other bidders will keep that in mind in making their own bids." [61] Some decried Farley J.'s use of the term "functional veto" because the term "veto" implies, to some minds, a voting veto, such as that held by creditors. However, the term is nevertheless an accurate assessment of the practical implications of the facts as they existed in the Stelco restructuring.

In addition, the Province held a further "functional veto". As at the date of filing, Stelco was not required to make special payments with respect to funding its solvency deficiency in its four pension plans as a result of an election it had made pursuant to s. 5.1 of Regulation 909 [62] under the *Pension Benefits Act*, [63] described by many as the "too big to fail" exemption. The wisdom of this exemption may well be questioned, and it would be more accurately described, in any event, as the "too big to fail without disastrous consequences" exemption. As Stelco and Air Canada both came close to proving, no employer is too big to fail. The exemption was implemented by regulation, and the Province took the position that Stelco's ability to avail itself of the exemption could be revoked by regulation. The Province gave notice of its intention to revoke Stelco's ability to so avail itself (once the CCAA stay was lifted) on the eve of the finalization of the court-approved process put in place to identify purchasers or investors for all or part of Stelco. In a letter much criticized by many Stelco stakeholders and referred to as a "bombshell" by Farley J., [64] the special advisor to the Province, E. James Arnett, wrote:

> The "qualifying" plan status refers, of course, to the election Stelco made many years ago under Section 5.1 of the Regulations under the *Pensions Benefits Act* (Ontario), which allowed Stelco to avoid solvency funding obligations on the premise it was "too big to fail".
>
> By filing for CCAA protection, Stelco gave notice that it was not "too big to fail". Since it is now clear that there is significant enterprise value at Stelco, it is only reasonable that a plan should be forthcoming to eliminate reliance upon the privileges of Section 5.1.

> Accordingly, I have been instructed to advise you that, upon emergence from CCAA, Stelco will not be entitled to the benefit of Section 5.1. It is essential that your Board and Committee understand this in assessing the various bids. [65]

Although some questioned whether the Province had the political will to revoke Stelco's ability to rely on s. 5.1 of the Regulation, the letter certainly left no doubt about the expressed intention of the Province in this regard. Again, viewed as a practical matter, no investor, purchaser or plan sponsor would likely commit the financing necessary to restructure Stelco without a solution to the pension-funding issue. In other words, the Province created its own "functional veto" over the restructuring process. Furthermore, it should be noted that, unlike the situation in *Air Canada*, the affected employees and pensioners were in a concentrated area in Southern Ontario, whereas the affected employees and pensioners of Air Canada were dispersed more widely. The economic and political consequences of a failed restructuring would likewise be more concentrated for Stelco than Air Canada, which may have translated into more political leverage. The unions in the *Stelco* case did an admirable job of adding political pressure to their negotiating leverage, which may have had an impact on some of the positions taken by the Province in the restructuring.

In the end result, U.S.W., Local 8782 negotiated a collective agreement that included wage and benefit increases and a signing bonus, a far cry from the concessions extracted from Air Canada's unions. However, the above analysis provides a background and, it is hoped, some explanation as to how and why these differing results occurred.

It should be noted that USW Local 1005 of the Hamilton plant was not as active as U.S.W., Local 8782 and the U.S.W. International. U.S.W., Local 1005's collective agreement did not expire until after the end of Stelco's proceedings and no attempt was made to open it during the proceedings. As U.S.W., Local 1005 noted many times during the proceedings, its members continued to make the steel at Hamilton as they had for many years and Stelco continued to pay their wages, benefits, and pensions as agreed. A new collective agreement was negotiated shortly after Stelco's restructuring by the new owners and management of Stelco (installed as part of the restructuring) and such occurred without any labour disruption. While many may question the decision of U.S.W., Local 1005 to minimize its participation in the CCAA restructuring of Stelco, perhaps they were simply adhering to the old adage that "Sometimes, if you don't want to lose, it is best not to play the game".

5. — Future Implications

What do these cases suggest in terms of future dealings with unions? Some have argued that the combination of (a) the Supreme Court of Canada's decision in *GMAC Commercial Credit Corp. — Canada v. TCT Logistics Inc.* [66] to the effect that a receivership order cannot exclude employer liabilities nor oust the exclusive jurisdiction of the labour relations board to determine if someone is a successor employer; (b) the amendments proposed by Chapter 47; and (c) the implications arising from the success of the unions in the Stelco restructuring will lead to a dramatically different negotiating environment in restructurings involving organized labour.

The authors caution against any such sweeping generalities. *TCT Logistics* did nothing more than clarify the law and does not represent an advance or retrenchment either way. If interim receivers, receivers and managers or trustees actually direct an employee's activities and pay their wages, they will be held to be employers. This has been the case in Ontario, at least since amendments were made to the *Employment Standards Act, 2000* [67] that added the words "trustees and receivers" to the inclusive definition of "employer" under that Act. Furthermore, if the employees in question happen to be unionized and subject to a collective agreement, then the collective agreement will be binding on the employing receiver, interim receiver, or trustee.

While the unproclaimed amendments contemplated by Chapter 47 may weaken a debtor company's negotiating leverage in some respects, it is likely to have little practical effect. Unions and employers both know that any court under the existing regime would be reluctant to impose an unwanted collective agreement and that a negotiated solution in the critical field of employment relations is practically a necessity in any restructuring. While many would have welcomed amendments to the law that would increase the negotiating leverage of debtor companies over their unions so as to make restructuring easier, the proposed changes in Chapter 47 are not likely to make restructurings significantly more difficult than currently is the case. If

Chapter 47 is proclaimed, in future, as now, debtor companies that truly require concessions from organized labour will have to present a compelling case to their unions and achieve a result through good, old-fashioned, hard bargaining.

As can be extruded from the analysis of the *Stelco* and *Air Canada* cases, bargaining leverage is dictated in significant measure by the parties' likely alternative outcome to a restructuring. Where that outcome is uncertain and potentially disastrous (i.e., significant job losses), such as in Air Canada, it can reasonably be anticipated that concessions will be achieved. Where the outcome is reasonably certain and represents a likely continuation of, or even enhancement to, the status quo, such as in Stelco, at least with respect to the Lake Erie plant, concessions are less likely.

These fundamental elements of bargaining leverage have not been overridden by any court decision, Chapter 47, or the outcome of any particular case. Each restructuring situation has to be measured and judged by its own particular facts.

However, while no paradigm shifts have occurred with respect to bargaining with unions, the experience of Stelco will likely result in unions taking more aggressive positions, better understanding their negotiation position, and attempting to more effectively benefit from the leverage they have. In the authors' view, unions are more likely to adopt the active strategies employed by the Lake Erie Local in Stelco rather than the passive strategy employed by the Hamilton Local. In addition, it should be noted that organized labour has demonstrated an ability to learn from the experiences of prior restructurings.

Notwithstanding the above, it should be remembered, as an overriding caveat, that the circumstances of the Stelco restructuring are unique among the annals of corporate restructuring in Canada. Therefore, although changes in attitude and expectations may now abound, true negotiating leverage, and therefore the outcome of future restructurings, will depend upon the facts of the particular situation.

IX. — Conclusion

In summary, the restructuring of Air Canada and Stelco were significant milestones in the history of restructuring in Canada. A comparison of some of the salient features of the two restructurings is instructive. Among the conclusions to be reached are the following:

(a) restructuring under the CCAA is a dynamic, chaotic, but effective system that facilitates significant structural, financial, and other restructuring of major public corporate enterprises in Canada;

(b) the flexibility inherent in the CCAA process is key component to the effectiveness of the restructuring system, which should be guarded and enhanced where possible;

(c) the CCAA restructuring process encourages deal-making over judicial intervention to impose results and therefore favours a business environment over a legal environment. This is appropriate and should be protected and nurtured where possible;

(d) real crises are needed to compel real concessions; and

(e) the future is uncertain. Stakeholders and their counsel must adapt, and adapt quickly, to changing circumstances.

Footnotes

* Robert Thornton is a founding partner of ThorntonGroutFinnigan LLP, Toronto, Ontario; with contributions by James H. Grout, Kyla Mahar, and Greg Azeff.

2 Initial Order granted April 1, 2003, exit closing September 30, 2004.

3 Initial Order granted January 29, 2004, exit closing March 31, 2006.

4 R.S.C. 1985, c. C-36.

5 ThorntonGroutFinnigan LLP (TGF) acted as special insolvency counsel to GE Capital Aviation Services, Inc. (GECAS), which was the largest single creditor of Air Canada, leasing or administering leases for approximately one-third of Air Canada's fleet, and was one of the two arms of GE that provided the DIP facility and exit financing to Air Canada. In *Stelco*, TGF acted for Ernst & Young Inc. as Monitor.

6 Affidavit of M. Robert Peterson, sworn April 1, 2003 [Peterson Affidavit].

7 *Air Canada, Re* (April 1, 2003), Farley J. (Ont. S.C.J. [Commercial List]) at para. 33 [AC Initial Order].

8 First Report of the Monitor dated April 17, 2003, at para. 44.

9 *Air Canada, Re* (2003), 2003 CarswellOnt 1220, [2003] O.J. No. 1158, ¶5 (S.C.J.).

10 *The Insolvency Institute of Canada and Canadian Association of Insolvency and Restructuring Professionals Joint Task Force on Business Insolvency Law Reform*, dated March 15, 2002 and presented to the Senate on May 8, 2003.

11 *Stelco Inc., Re* (2004), 2004 CarswellOnt 483, [2004] O.J. No. 549 (Ont. S.C.J. [Commercial List]) [Stelco Initial Order].

12 *Acre T Farms Ltd., Re* (October 10, 2003), ¶21, Swinton J..

13 See s. 11.2 of Bill C-55, *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47 [*Chapter 47*], which contains a comprehensive set of amendments to Canada's insolvency law framework. Not in force at the time of writing this paper.

14 *Royal Oak Mines Inc., Re* (1999), 6 C.B.R. (4th) 314 (Ont. Gen. Div. [Commercial List]).

15 *Trafalgar Motors, Re* (1952), 33 C.B.R. 87 (Ont. S.C.).

16 Submissions of counsel on DIP approval motion April 25, 2003.

17 Based very unscientifically upon the increased traffic in unsolicited offers clogging the authors' email seeking such opportunities. It is also noted that even Canadian major banks have now entered the DIP financing market.

18 Aristotle, *Politics*, http://plato.stanford.edu/entries/aristotle-politics/.

19 Robert Burns, "To a Mouse" in James Kinsley, Ed., *Burns Poems and Songs* (London: Oxford University Press, 1969) at 101-102.

20 Affidavit of William E. Vaughan, sworn January 29, 2003, at para. 123 [Vaughan Affidavit].

21 Stelco Initial Order, *supra*, note 10.

22 *Stelco Inc., Re* (2004), 2004 CarswellOnt 483, [2004] O.J. No. 549, ¶1 (Ont. S.C.J. [Commercial List]).

23 *Stelco Inc., Re* (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]) [*Stelco-Insolvency*].

24 R.S.C. 1985, c. B-3.

25 *Stelco-Insolvency*, *supra*, note 22, at para. 41.

26 BIA, *supra*, note 23, s. 2 — definition of "insolvent person".

27 *Stelco-Insolvency*, *supra*, note 22, at para. 67.

28 *Ibid.*, at para. 50.

29 *Ibid.*, at para. 66.

30 *Ibid.*, at paras. 25-26.

31 *Stelco Inc., Re* (2004), 2004 CarswellOnt 2936, [2004] O.J. No. 1903 (Ont. C.A.).

32 *Stelco Inc., Re* (2004), 2004 CarswellOnt 5200, 2004 CarswellOnt 5201, [2004] S.C.C.A. No. 336 (S.C.C.).

33 One of the authors describes this as the "Michael Jackson Rule of Restructuring: Stakeholders won't make concessions until the baby is hanging over the balcony."

34 A "hockey stick" projection is one that forecasts an extraordinary, sharp, and prolonged upturn in economic fortunes such that the resulting graph takes on the characteristics of a hockey stick or sharp left angled upturn as seen in Appendix "A-2" from Q4 2003 through Q3 2004.

35 R.S.C. 1985, c. C-44.

36 R.S.C. 1985, c. 35 (4th Supp.).

37 R.S.C. 1985, c. 31 (4th Supp.).

38 See *supra*, note 12, S.C. 2005, c. 47, s. 11.1. Interestingly, the government chose to explicitly remove a CCAA court's ability to restrain regulatory activity except in prescribed circumstances. See also see 7(iii), "The Effect of Chapter 47 on Regulatory Activity: The Pendulum Swings Too Far", *infra*.

39 S.C. 1996, c. 10.

40 *Air Canada, Re* (July 21, 2003), Doc. Toronto 03-CL-4932, ¶13 (Ont. S.C.J.); leave to appeal refused (December 23, 2003), Doc. M30256 (Ont. C.A.) [*AC Regulation Decision*].

41 *Ibid.*, at para. 16. See also S.C. 2005, c. 47, s. 11.02(4), which provides that "Orders doing anything referred to in subsection (1) or (2) may only be made under this section." Subsections 11.02(1) and (2) provide the court with the authority to issue a stay of proceedings. Parliament clearly intended to try to eliminate the court's inherent jurisdiction to stay proceedings (including proceedings by regulators, which are generally exempted from the stay provisions under Chapter 47) from CCAA restructurings.

42 *AC Regulation Decision*, *supra*, note 42, at para. 14.

43 *Ibid.*, at para. 28.

44 *Ibid.*

45 *Coba Industries Ltd. v. Millie's Holdings (Canada) Ltd.* (1985), 20 D.L.R. (4th) 689 (B.C. C.A.) at 696-97, approved by *Telford v. Holt* (1987), 41 D.L.R. (4th) 385 at 398-99 (S.C.C.).

46 R.S.C. 1985, c. W-11.

47 *Air Canada, Re* (2003), 45 C.B.R. (4th) 13 (Ont. S.C.J.).

48 *Ibid.*, at paras. 7, 10, 25, and 26.

49 AC Initial Order, at para. 55.

50 *Air Canada, Re* (2004), 2004 CarswellOnt 165 (Ont. S.C.J. [Commercial List]).

51 Stelco Initial Order, at para. 58.

52 *Chapter 47*, *supra*, note 12, s. 131.

53 For the purpose of simplicity and to illustrate the progress of the negotiations with the major stakeholders only, this timeline omits the achievements of Stelco in negotiating sales of various subsidiaries determined as necessary to restructure Stelco on a financial and operational basis.

54 11 U.S.C. § 1113.

55 *Mine Jeffrey inc., Re* (2003), 40 C.B.R. (4th) 95 (Que. C.A.).

56 Peterson Affidavit, *supra*, note 5, at para. 6.

57 *Ibid.*, at para. 122.

58 *Ibid.*

59 Vaughan Affidavit, *supra*, note 19, at para. 8.

60 *Stelco Inc., Re* (2004), 2004 CarswellOnt 5076, [2004] O.J. No. 4899 (Ont. S.C.J. [Commercial List]).

61 *Ibid.*, at para. 1.

62 General Regulation (made under the *Pension Benefits Act*), R.R.O. 1990, Reg. 909.

63 R.S.O. 1990, c. P.8.

64 *Stelco Inc., Re* (2005), 15 C.B.R. (5th) 279, ¶3 (Ont. S.C.J).

65 Letter dated February 9, 2005, from E. James Arnett to John Caldwell, Chair, Stelco Restructuring Committee.

66 (2006), 22 C.B.R. (5th) 163 (S.C.C.) [*TCT Logistics*].

67 S.O. 2000, c. 41.

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