The Role of the Monitor and Its Impact on US Restructurings

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In recent years, the variety of roles undertaken by court-appointed monitors in reorganizations under the CCAA has considerably expanded

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THESE ARE THE three most frequent questions that our colleagues outside Canada ask when they face a Canadian restructuring under the *Companies' Creditors Arrangement Act* ("*CCAA*"): Who is this monitor? What is its role? Who does it represent?

The most simple, textbook answer to the first question is probably the following: A monitor is usually an accounting or financial advisory firm that must be licensed to act as a trustee in bankruptcy under the Canadian *Bankruptcy and Insolvency Act* ("*BIA*"). Accordingly, monitors tend to be professionals in Canadian accounting or financial advisory firms who have obtained their Chartered Insolvency and Restructuring Professional ("CIRP") designation from the Canadian Association of Insolvency and Restructuring Professionals.

That being said, the monitor is much more. Aside from the debtor company, the monitor has become the most important player under the *CCAA*, the Canadian equivalent of Chapter 11 of the US *Bankruptcy Code* ("Chapter 11").

In recent years, the variety of roles undertaken by court-appointed monitors in reorganizations under the *CCAA* has considerably expanded. At one time, an appointment of the monitor was by virtue of the inherent jurisdiction of the court under the *CCAA*, but now the appointment is a statutory requirement[1] that includes active participation by the monitor in the restructuring process. One could say that the amendments to the *CCAA* that came into force in 2009 have further expanded the powers and the duties of monitors, although it is more or less a codification of the existing practice. However, it seems that the courts have expanded and tailored the monitor's role, including its powers and obligations, beyond the *CCAA* amendments.

We understand that for our non-Canadian colleagues, the monitor is a "creature" whose role is sometimes difficult to grasp and understand. This misunderstanding can probably be explained by the lack of a similar player under virtually all international restructuring legisla-

tion, the multiple hats that a monitor wears during a restructuring and the fact that debtor-in-possession ("DIP") restructuring is less common outside North America.

This commentary will address the myriad roles of the monitor.

1. THE STATUTORY ROLES OF THE MONITOR

Section 11.7 (1) of the *CCAA* states that the court, when issuing an initial order under the *CCAA*, must appoint a licensed bankruptcy trustee to monitor the business and the financial affairs of the debtor company. This order will grant the court's protection to a debtor company. The main function of the monitor is to report to the court on the debtor company's ongoing financial situation and on its efforts to develop a plan of arrangement. This traditional role has, however, evolved, and it has been expanded and tailored by the initial (and subsequent) orders to meet the specific needs of the situation of the debtor company.

In order to adequately assess the business and financial affairs of the debtor company, the monitor is given wide access to the debtor company's property, including the premises, books, records, data and other financial documents of a debtor company.[2] The monitor can also investigate the state of the company's business and financial affairs, as well as the cause of its financial difficulties.[3] It is the monitor's duty to undertake such an investigation for the benefit of the court and the creditors. The debtor company must assist the monitor and provide the requested information.[4] The process of gathering information related to the financial situation of the debtor company can present certain challenges for the monitor. For example, the information may be unreported or disorganized, and key employees may have left the debtor company.

With respect to the monitor's obligation to report to the court, the *CCAA* states that the monitor must "file a report [...] on the state of the company's business and financial affairs."[5] Such reports must be filed by the monitor in the following circumstances: (i) shortly after its appointment, (ii) within 45 days of the end of the company's financial quarter, (iii) before a meeting of the creditors, (iv) before an extension of the court's protection and (v) as directed by the court.[6] A similar report must be filed with the court after any assertion by the monitor of an adverse material change in the debtor company's projected cash flow or financial circumstances.[7] The *CCAA* does not exhaustively define the information that must be disclosed in a monitor's report. The monitor retains a certain discretion regarding the level of detail or information it must provide in the report, knowing that the court and the creditors must have a complete picture of the financial situation and affairs of the debtor company, including the efforts and likelihood of the filing of a plan of arrangement. Ultimately, the monitor must present a report that reflects the information that was made available to it or discovered.

Court-appointed monitors play a very significant and important role in *CCAA* proceedings. The 2009 amendments to the *CCAA* and the use of the inherent jurisdiction of the court allow for the granting of initial orders that include wider duties granted to the monitor than those suggested by s. 11.7 (1) of the *CCAA*.[8] For instance, courts will consider the opinion of the monitor in the following situations:

(A) establishment of a super-priority for interim financing (s. 11.2 (4)(g) *CCAA*);
(B) assignment of contracts (s. 11.3 (3)(a) *CCAA*);
(C) disclaimer of contracts (s. 32 (4)(a) *CCAA*);
(D) disposition of the totality or parts of the company's assets outside the ordinary course of business (s. 36 (3) (b)(c) *CCAA*) (the equivalent of a 363 sale under Chapter 11);
(E) the reasonableness and fairness of any plan or arrangement proposed by the debtor company (s. 23 (1)(i) *CCAA*).

As well, the monitor must inform the court when it is of the opinion that it would be more beneficial to the debtor company's creditors if proceedings were continued under the *BIA*.[9]

Lastly, the monitor is also responsible for analyzing potential preferences or undervalued transactions that have occurred during the suspect period.[10] We believe that if monitors were more proactive with such power, it could have an important impact on cross-border restructurings. Indeed, historically, it has generally been the Unsecured Creditors' Committee (the "UCC") named in accordance with Chapter 11 that has initiated avoidance actions, but monitors might be better suited to play this role in their capacity as court officers and representatives of all creditors. This bring us to the question: Who is the monitor representing?

2. IS THE MONITOR A JACK OF ALL TRADES? WHOM DOES IT REPRESENT?

As evidenced by the foregoing, the powers of the monitor extend beyond the mere examination of the company's financial affairs and its monitoring. As the monitor takes on the larger role of overseeing the restructuring process, the following question arises: Whom is the monitor representing?

In a nutshell, during a restructuring process under the *CCAA* the monitor wears three different hats. First and foremost, the monitor is an officer of the court. In addition it will be an advisor to the debtor company and a representative of the creditors. [11]

As an advisor to the debtor company, the monitor accompanies the latter in its restructuring process. For instance, the monitor helps the debtor company in its establishment of a plan of arrangement, the organization of the creditors' meeting, the review and analysis of the proof of claims and its communications with various stakeholders. The appointment of monitors probably explains why appointments of a Chief Restructuring Officer ("CRO") have been more frequent under Chapter 11 than in restructurings pursued in accordance with the *CCAA*. Even if the roles of CROs and monitors share certain similarities, they should not be confused. A CRO is a senior officer of the debtor company and as such will not be as impartial as a monitor since its client will be the debtor company and its estate.

The role of the monitor, as a representative of the creditors, is mostly to protect and inform the various categories of creditors. The courts have concluded that monitors have a fiduciary duty to all the creditors. It serves as a "watchdog."[12] Although there are certain similarities to the UCC, the monitor should not be compared here to the UCC. Indeed, the UCC owes fiduciary duties only to the unsecured creditors, while the monitor must take into account the interests of all the participants in the restructuring process. The role played by the monitor usually has the effect of considerably confining the role played by the UCC in a *CCAA* process. The UCC will then play a role that is closer to that of an *ad hoc* committee than to a statutory committee. That being said, the UCC does still have two major advantages over the monitor in a cross-border restructuring because (i) it is less reluctant than the monitor to initiate avoidance actions and (ii) it can commence adverse proceedings on behalf of the debtor company.

Lastly, the monitors are primarily officers of the court and as such have been described as the "eyes and ears" of the court. In this role, the monitor is an independent officer of the court that essentially implements the court's commercial oversight of the restructuring proceedings. In this regard, the monitor is not an adversary in the restructuring proceedings and generally avoids taking adversarial positions directly

against any party. Rather, the monitor generally restricts itself to providing the court with its views on the commercial consequences of the positions of the parties. Therefore, the representations, suggestions and conclusions of the monitors are given substantial weight, and the courts give them considerable deference and, in most instances, are guided by their advice.

3.THE INDEPENDENCE OF THE MONITOR

As a result of the monitor's numerous mandates, conflicts can arise if stakeholders begin to question the balance between the multiple interests at stake. This concern will also increase when stakeholders realize that the monitor is a professional chosen and paid by the debtor company that will obtain, in virtually all cases, a charge ranking ahead of the secured creditors to guarantee its fees.

Thus, monitors have a duty to act independently with integrity and impartiality in assisting with the restructuring. Monitors are also mandated to act honestly and in good faith, comply with a prescribed code of ethics and act in the best interests of all stakeholders in the proceedings. Should a monitor breach these duties, the court may, upon an application of a creditor, replace it and appoint another licensed trustee to act as monitor.

To ensure that monitors are impartial and that they be perceived as such, they are required to be independent from the debtor company. For example, they cannot have been related to a director or have been the auditor of the debtor company at any time during the two preceding years of their appointment.

Furthermore, to protect the impartiality of the monitor and to keep it out of adversarial *CCAA* proceedings,[13] courts, especially outside the province of Québec, have usually held that the monitor cannot be compelled or cross-examined by parties to the restructuring. However, courts have recognized that the monitor can and should collaborate with the creditors and be available to answer questions on its reports. [14]

In the common-law provinces, it has been established that only in unusual or exceptional circumstances can a monitor be subjected to cross-examination on the basis of its reports.[15] These circumstances include the monitor's refusal to answer questions on the report as may be reasonably requested by the creditors[16] or partiality manifested by the monitor towards a party to the *CCAA* proceedings.[17] Even in these circumstances, the courts have favored informal and nonconfrontational approaches such as the submission of written questions to the monitor or an out-of-court interview.[18]

4. THE ROLE OF THE MONITOR IN CROSS-BORDER RESTRUCTURINGS

Recognition of *CCAA* Proceedings Under Chapter 15

In 2005, Canada and the United States each adopted the *Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law* (the "Model Law"). The Model Law is a United Nations initiative to harmonize national insolvency regimes in order to facilitate the efficient and equitable administration of cross-border insolvencies.

Canada implemented the Model Law through the 2009 amendments to the *BIA* and the *CCAA*. Since the amendments, Part IV of the *CCAA* has functioned as a complete code governing cross-border insolvencies under the *CCAA*. The United States has incorporated most of the Model Law through Chapter 15 of the US *Bankruptcy Code* ("Chapter 15"). By virtue of Chapter 15, a debtor company under *CCAA* protection must have the *CCAA* proceedings recognized in the United States if any orders rendered by the Canadian courts are to have extraterritorial effect.

To commence the process under Chapter 15, the debtor company must select an individual to act as a foreign representative of the debtor company. The foreign representative is the person who applies to the court for recognition of the foreign insolvency proceedings on behalf of the debtor company. Although the debtor company can act as foreign representative, we have seen in numerous cases the monitor, in its capacity as court-appointed officer, named as a "foreign representative" under Chapter 15 proceedings. This is, from a Canadian restructuring perspective, an extension of the monitor's duties and obligations.

The Monitor Can Play a Role as a Dealmaker in Cross-Border Restructurings

Most scholars, practitioners and commentators have stated that the restructuring process in the United States under Chapter 11 is much more adversarial and litigious than under the *CCAA* process. For the debtor company, a more litigious restructuring will generally mean a more expensive and time-consuming restructuring. We believe that monitors can play a key role in reducing the adversarial side of a restructuring and consequently the fees and time associated therewith.

As the court's independent and impartial officer, the monitor can assist the parties in resolving their disputes or, at the very least, limiting the scope of disputes. The monitor can be exceptionally useful at mediating disputes given that (i) it speaks (to a certain extent) on behalf of the court and (ii) the parties know very well that the monitor will eventually have to provide its comments to the court on the relative merit of each party's point of view and how the conclusions sought by the parties will affect the debtor company's restructuring. What the monitor thinks carries a lot of weight before the courts and thus may encourage the parties to resolve their disputes.

The Monitor Can Be the Watchdog of the Canadian Creditors in a Cross-Border Restructuring

Illustrations of the watchdog role of the monitor can be found in the cross-border restructurings of White Birch Paper Holding Company and of the US electronic retailer Circuit City and of its Canadian subsidiary, Intertan.

In the Circuit City matter, Circuit City filed under Chapter 11 in Virginia and obtained an interim order approving a DIP facility, which required a guarantee by Intertan and a court-ordered charge ranking in priority over unsecured creditors. Intertan subsequently commenced restructuring proceedings under the *CCAA* and sought an order from the court granting a charge over its assets to secure the US DIP facility. The Canadian court was advised that the charge was a non-negotiable condition precedent to the DIP lenders' provision of the DIP facility and that without this facility, the US business would fail. The court granted the order sought. Circuit City and its UCC subsequently agreed to exclude certain assets from the scope of the DIP security in the United States, which had the indirect effect of increasing the Canadian creditors' exposure. Intertan's monitor filed a report to the Canadian court to the effect that the US DIP facility and the Canadian DIP security could allow unsecured creditors of Circuit City to have access to the applicant's assets and achieve recovery ahead of the unsecured creditors of Intertan. Accordingly, the monitor applied for, and the Canadian court issued, various orders aimed at protecting the interests of Intertan's unsecured creditors.[19]

In the White Birch Paper Holding Company matter, the Canadian debtors (collectively, "White Birch Canada") obtained protection under the *CCAA* in February 2010. The Québec Superior Court subsequently approved a stalking horse bid process for the sale of the vast majority of the assets of White Birch Canada and of its US subsidiary, Bear Island, which had itself commenced proceedings under Chapter 11.[20] The monitor subsequently filed a report to bring ongoing discus-

sions regarding the allocation of the proceeds of the assets sale to the attention of the Québec Superior Court and to alert it to the possibility that the allocation methodology to be approved by the US Bankruptcy Court could favor Bear Island's estate to the detriment of creditors with claims against White Birch Canada. The monitor therefore asked the Québec Superior Court to order that a joint hearing between the US Bankruptcy Court and the Québec Superior Court be held to deal with the allocation of the proceeds of the assets sale. The Québec Superior Court noted that the allocation of the proceeds should not be the result of a unilateral decision by it or the US Bankruptcy Court and that the final allocation would probably have to be ratified by both courts.[21] However, the Québec Superior Court decided that a joint hearing was not warranted at that point as the various stakeholders were still negotiating in order to arrive at a settlement of the allocation issue, which was apparently the case. Thus, the intervention by the monitor apparently forced the parties to come to a settlement that was acceptable to the Canadian creditors of White Birch.

CONCLUSION

We believe that any cross-border restructuring could benefit from the intervention of an impartial officer of the court, such as the monitor, that can report to the court and the stakeholders in a completely neutral fashion about the debtor company's operations, transactions and financial situation.

Practitioners outside Canada who have experienced dealings with a monitor have said that its role is very successful and best serves the interests of all stakeholders. The deference given to the monitor by the court and the ethics shown by monitors have made this court officer a key player in any restructuring. We believe that this role enhances the process and facilitates restructuring. We also think that constant effort by the courts to promote cooperation in cross-border restructurings will allow the monitor to play an even bigger role in the years to come.

[1] Section 11.7 (1) *CCAA*. [2] Section 24 *CCAA*. [3] Section 23 (1)(c) *CCAA*. [4] Section 35 *CCAA*. In addition, the company must comply with the duties set out in section 158 *BIA*. [5] Section 23 (1) (b) and (d) *CCAA*. [6] *Idem*. [7] Section 23 (1) (d) (i) *CCAA*. [8] For a review of the developments in the role of monitors, see Douglas I. Knowles, "To Liquidate or Restructure Under the *CCAA*? The Monitor's Conflicting Duties" (2006) *Annual Review of Insolvency Law* 95. [9] Section 23 (1)(h) *CCAA*. [10] Section 36.1 *CCAA*. [11] *Ivaco Inc., Re*, 2006 CanLII 34551, para. 55. [12] *United Used Auto & Truck Parts Ltd. v. Aziz*, 2000 BCCA 146. [13] *Pine Valley Mining Corporation (Re)*, 2008 BCSC 446, paras. 9-18; *Bell Canada International Inc. (Re)*, [2003] O.J. No. 4738, para. 8. [14] *Mortgage Insurance Co. v. Innisfil Landfill Corp.*, 1995 CanLII 7366, para. 5. [15] *Bakemates International Inc. (Re)*, [2002] O.J. No. 3569, paras. 31-32; *Bell Canada International Inc. (Re)*, [2003] O.J. No. 4738. [16] *Bell Canada International Inc. (Re)*, [2003] O.J. No. 4738, para. 8. [17] *SemCanada Crude Co. (Re)*, 2010 ABQB 531, para. 100. [18] For example, see *Bakemates International (Re)*, [2001] O.J. No. 2024 (overturned on appeal for other reasons). [19] *Intertan Canada Ltd.* (Re), 2009 49 CBR (5th) 232. [20] *Re White Birch Paper Holding Company*, 2010 QCCS 4915, appeal dismissed 2010 QCCA 1950. [21] *Re White Birch Paper Holding Company*, 2011 QCCS 5223.

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