



FRASER MILNER CASGRAIN LLP

## **THE RISE (AND FALL?) OF INTERIM RECEIVERSHIPS**

**By R. Shayne Kukulowicz\* and John D. Russo\*\***

Over the past decade, interim receivers appointed pursuant to the *Bankruptcy and Insolvency Act*<sup>1</sup> (the "BIA") have played an increasingly prominent role in insolvencies in Ontario and, more recently, in other Canadian jurisdictions. Interim receiverships have been expanded from an interim conservatory measure into a comprehensive remedy that co-exists with, or even supercedes, a traditional receivership.

As a result of the court's wide discretion in respect of the scope of an interim receiver's powers, interim receiverships have been able to effectively respond to the complexities of various insolvent enterprises. At the same time, interim receiverships have distinct advantages over traditional receiverships including, most notably, the fact that the appointment is effective in all provinces across Canada.

Notwithstanding the advantages and effectiveness of interim receivers, the transformation from their original conservatory role has raised concerns that their powers may have been expanded far beyond their intended purpose and, without certain limits being imposed, interim receiverships could be overly prejudicial to third parties. While admittedly a historical term, the title "interim" is becoming less relevant in the context of full liquidations which may last for years and when most practitioners would have difficulty answering the question - "interim to what?".

The recent decision out of Alberta in *Re Big Sky Living Inc.*<sup>2</sup>, as well as, the latest review process for legislative reform of the BIA, have sparked debate as to whether interim receiverships have gone too far and should be limited in some fashion. This article will discuss the rise of interim receiverships, the impact of the *Big Sky* case and the future of this remedy in Canadian insolvencies.

### **The Rise of Interim Receiverships**

In 1992 a number of very significant amendments were made to the BIA. Among the amendments, the commercial reorganization sections were revised to include secured creditors in the general stay of proceedings. Various duties and obligations of receivers were codified. Unpaid suppliers were given rights of repossession in certain circumstances. A 10 day statutory notice requirement was imposed on secured creditors prior to the enforcement of security.

More particular to interim receiverships, the restriction on the enforcement rights of secured creditors under BIA proposals and the mandatory 10 day statutory notice under

section 244 were accompanied by expanding the BIA interim receivership provisions in order to provide a "protective" mechanism which would be available to secured creditors while their rights were restricted. With the scope of the powers of interim receivers largely undefined in these circumstances, interim receiverships have evolved into very powerful mechanisms - no doubt a lot more powerful than the drafters of the amendments had anticipated.

A brief summary of the applicable interim receivership provisions begins with section 46 of the BIA which pre-dates the 1992 amendments and remains in effect. In order to make an appointment under section 46, the court must be satisfied that an interim receiver is necessary for the "protection of the debtor's estate" during the period following the filing of a bankruptcy petition. Moreover, section 46(2) limits the interim receiver's powers to taking conservatory and protective measures, with the proviso that the interim receiver "shall not unduly interfere with the debtor in the carrying on of his business". Accordingly, the primary task of such interim receiver is to act as a monitor to protect the estate during the period between the issuance of a petition and the making of a receiving order.

As a result of the 1992 amendments, a court may also appoint an interim receiver pursuant to section 47 (in the context of a secured creditor delivering or about to deliver a 10 day notice of intention to enforce security) and section 47.1 (in the context of proposal proceedings). In such circumstances, the court may direct the interim receiver to take possession of assets, exercise control over the property and business of a debtor and take such other action as the "court considers advisable" in order to protect the debtor's estate or the interests of various creditors, including secured creditors. It is of particular note that the amended interim receivership sections have no statutory prohibition against an interim receiver unduly interfering with a debtor's business.

While the restriction against undue interference has led courts to strictly limit the powers of interim receivers appointed pursuant to section 46, the courts have taken a much broader view of their authority under sections 47 and 47.1 to direct an interim receiver to take such actions "as the court considers advisable". As will be illustrated by the following three Ontario decisions during the past decade, these provisions have been broadly interpreted with the effect that interim receiverships have evolved into mechanisms that rival traditional receiverships.

*Canada v. Curragh Inc.*<sup>3</sup> was decided in 1994, two years after the 1992 amendments, and involved the appointment of an interim receiver under section 47 to effect the sale of assets in various jurisdictions. The property at issue was subject to significant environmental concerns and the interim receivership was used to convey title without the interim receiver actually going into possession of the assets. Recognizing the marked departure from the traditional role of an interim receiver, the Court observed that the 1992 amendments to the BIA would change the way the judiciary, as well as, insolvency and restructuring practitioners, would view the legislation governing the appointment of interim receivers. In an expansive interpretation of an interim receiver's function, the Court observed that it could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands".

The trend towards expansive interim receiverships continued in *Re T. Eaton Co.*<sup>4</sup>, where an interim receiver under section 47.1 was authorized to effect the liquidation of inventory in the context of proposal proceedings under the BIA. In this case, the Court granted an order appointing an interim receiver with authority to take possession of personal property, to enter into an agency agreement with various liquidators and to control all of Eatons' receipts and disbursements, but not to otherwise interfere with the Eatons business. The Court also declared that the agency agreement was a judicial sale in order to avoid issues under the *Bulk Sales Act*<sup>5</sup>. The strategies used in *Eatons* illustrate the flexibility of section 47.1 and the willingness of courts to use this section to facilitate certain processes, such as a liquidation of a significant portion of the debtor's assets in the context of a reorganization proceeding.

The final illustrative case is *Harris Trust & Savings Bank v. Anicom Multimedia Wiring Systems Inc.*<sup>6</sup> in which an interim receiver was appointed under section 47 to sell a business as a going concern following the delivery of a section 244 notice by its primary secured creditor. The appointment of the interim receiver, coupled with a stay of proceedings, had the effect of immediately normalizing operations and preserving the business across Canada pending the sale. After the impending sale aborted, the interim receiver was empowered to control the operations and to enter into a marketing process that culminated in the sale of the on-going business to a different purchaser for a significantly higher purchase price.

While the sale of the business as a going concern by the interim receiver preserved hundreds of jobs and maximized the realizations to the lender, there was significant concern in the *Anicom* case regarding the effect of the interim receivership on the rights of unpaid suppliers. A number of suppliers asserted that, in the circumstances, the interim receiver in *Anicom* was for all intents and purposes a "traditional receiver" which should trigger their rights under section 81.1 of the BIA to repossess goods delivered within 30 days prior to the appointment.

The Court in *Anicom* affirmed an earlier decision in *Bruce Agra Foods Inc. v. Proposal of Everfresh Beverages Inc. (Receiver of)*<sup>7</sup> which held that an interim receiver is not a "receiver" for the purposes of section 81.1 of the BIA. In short, section 81.1 rights only arise upon a bankruptcy or the appointment of a "receiver within the meaning of section 243". Under section 243, a "receiver" is a person who is appointed to take control of a debtor's property pursuant to a security agreement or by a Court *not* exercising its jurisdiction in bankruptcy. The appointment of an interim receiver under the BIA is clearly made by a court exercising its bankruptcy jurisdiction, and therefore the Court concluded that an unpaid supplier's rights under section 81.1 do not arise.

The three cases discussed above are intended to illustrate the evolution of the interim receivership into a mechanism that in many cases is replacing traditional receiverships. Insolvency professionals have come to appreciate the flexibility of this remedy and the fact that an appointment is effective in other provinces where the business or assets may be located. Moreover, secured creditors have no doubt seized upon this mechanism in order to circumvent a debtor's right to a 10 day notice period before the enforcement of

security, a debtor's right to a stay of proceedings under the proposal provisions, and an unpaid supplier's right to repossession.

### **The Fall of Interim Receiverships?**

The *Big Sky* decision, which is discussed below, along with the growing concern that interim receiverships have been expanded far beyond their apparent purposes, lead to the question of whether we are witnessing the "fall" of interim receiverships.

Interim receiverships clearly appear to have expanded beyond the intentions of the drafters of the 1992 amendments. It is unlikely the drafters could have contemplated that interim receivers would evolve to have traditional receivership powers but would avoid being a "receiver" to the detriment of unpaid suppliers (the same unpaid suppliers whose rights were created with great fanfare by the amendments). Similarly, the amendments included provisions that impose duties on, and regulate the conduct of, "receivers". Again, it is questionable whether the drafters intended that such provisions would not apply to an interim receiver possessing all of the powers of a traditional receiver.

The greatest area of controversy is the impact of interim receiverships on the rights of third parties, such as suppliers, landlords, employees, government agencies, etc. This issue is compounded because appointment orders affecting such rights are often granted with little or no opposition from the debtor and with little or no notice to third parties. In the vast majority of cases, the courts are being put in the position of considering comprehensive "standard form" orders which impact on parties who are not present and may not even be specifically identified at that point.

The recent *Big Sky* decision from the Alberta Court of Queen's Bench involved a detailed analysis of the proper scope of an order appointing an interim receiver under the BIA. An original *ex parte* order had been granted by the Court subject to a short return date for counsel to address the Court's concerns regarding the breadth and complexity of the order and the lack of service on parties potentially affected by its terms. On the return date, the debtor consented to the form of the order and other major secured creditors were not opposing. Nevertheless, the Court was still concerned about the scope of the "standard form" order and it proceeded to critique the order, basically paragraph by paragraph.

Although recognizing that the wording of section 47 is very broad in respect of the discretion to grant powers to an interim receiver, the Court in *Big Sky* found that it must have regard to what is "truly necessary" for the protection of the estate and the creditors. The Court took serious issue with the fact that the order was "overly broad" and "declaratory" and refused to grant provisions in the order on the basis that they exceeded the provisions of the BIA and were "legislative" in nature. With regard to third parties, the Court stated that while it is "appropriate to anticipate powers that the interim receiver might require in the future, it is less appropriate to try and anticipate and cut-off rights of third parties that might exist". Although the proposed order contained a "variation

clause" (also commonly known as a "comeback clause") that entitled affected parties to come forward and have the order amended, the Court viewed such clause as inadequate to justify the broad relief sought.

Finally, in what may be considered general commentary, the Court observed that section 47 appears to contemplate an interim receiver being appointed for a "brief" period only to protect the interest of the creditors while the 10-day section 244 notice period is running. Moreover, the Court commented that the section does not appear to contemplate the interim receiver will actually carry on the business of the debtor.

Contrary to the Court's commentary, the ability of an interim receiver to carry on a business is not precluded by section 47 and the test is what is necessary for the protection of an estate or creditors. In circumstances such as management abandoning a failing business or actively taking steps to the detriment of creditors, the appointment of an interim receiver to carry on the business may be exactly what is "truly necessary".

In isolation, the balance of the analysis by the Court in *Big Sky* is somewhat compelling in favor of stricter limitations on the scope of interim receivership orders. There is no doubt that interim receivership orders do have broad implications to numerous third parties. Nevertheless, the debate regarding the impact of such orders and the broad declaratory provisions is not limited to interim receiverships. For the most part, the issues are common to traditional receivership orders and initial orders under the *Companies' Creditors Arrangement Act*<sup>8</sup> (the "CCAA") where, in fact, most of these provisions find their origin. The choice in all of these situations is between a broad initial order that has the effect of restricting third party rights for the sake of the business enterprise as a whole, and a narrow order that risks a total meltdown of the business and destruction of value as third parties scramble to take self-interested steps. In terms of the "legislative" nature of such orders, the whole focus is to create an environment where insolvency professionals are prepared to act without significant liability issues which may result from the appointment itself or taking such steps as are directed by the court.

In *Big Sky*, the lack of details regarding the insolvent business makes it difficult to assess whether the Court's criticisms of the proposed order were in the context of what was "truly necessary" to protect various interests in that particular case or the practice of granting comprehensive interim receivership orders in general. In any event, the significance of *Big Sky* on future interim receiverships (or receiverships or CCAA orders for that matter) should be evaluated by applying its reasoning to the realities of most insolvent businesses.

The reasoning in *Big Sky* is less practical in the context of the chaos that generally precedes an insolvency filing. When insolvency professionals first arrive on the scene, they are commonly faced with a company about to miss its payroll, landlords terminating leases, creditors refusing to ship product, key management personnel resigning, utilities threatening to cut off services, incomplete records because the company can not afford to keep them up to date and so on. In most cases it is virtually impossible to serve, let alone identify, all parties who may be affected by an initial order or to determine the degree to which their rights need to be affected. Absent a broad stay of proceedings and other

provisions that impact on the rights of third parties, the interim receiver will waste valuable resources and be diverted from its main purpose of protecting the business and the interests of creditors.

To balance the restrictions imposed on third parties and the lack of notice, courts have generally relied upon the comeback clause so that third parties have the right to apply for a variation of the order. The Court in *Big Sky* was critical of such clause on the basis that it was unfair to put the onus on third parties to seek a variation and the passage of time itself may lead to prejudice. Contrary to the criticisms in *Big Sky*, numerous other cases involving interim receiverships, receiverships and CCAA restructurings have demonstrated the effective operation of a comeback clause in order to balance the interests of all parties.

In the end, the *Big Sky* case does not justify the general restriction of interim receiverships nor should it be regarded as the turning point against this remedy.

### **The Future**

The flexibility of interim receiverships and the willingness of courts to take a broad view of the powers of an interim receiver have allowed these mechanisms to effectively respond to the complexities and uncertainties, particularly at the onset, of an insolvency of a commercial enterprise. Interim receiverships as we know them today are the result of 10 years of evolution where, in most cases, the effect has been to respond effectively to situations where other mechanisms would have been less than adequate.

On the horizon, it is expected that the interim receivership provisions will attract attention for legislative reform. The five-year review process of the BIA mandated by further amendments to the statute in 1997 is currently in progress and early next year should arrive at the stage of review by a Parliamentary Committee. Although the written submissions recently made to the Joint Task Force for Legislative Insolvency Reform make little reference to the interim receivership sections of the BIA, the Superintendent in Bankruptcy has assured insolvency professionals that interim receiverships are on the "radar screen". In particular, it is likely that the rights of unpaid suppliers in an interim receivership will be addressed in the next round of BIA amendments.

On the hope and assumption that future amendments do not drastically alter a useful mechanism, it should be emphasized that courts and insolvency practitioners have the means and already are addressing the obvious problems encountered in interim receiverships. For example, there have been a growing number of orders in which an interim receiver is appointed under the BIA and the same party is appointed as receiver pursuant to the provincial statute governing the appointment of receivers. This dual appointment has the advantage of being multi-jurisdictional while entitling unpaid suppliers to assert their rights under section 81.1. More attention is being paid to comeback clauses that will in all likelihood continue to be enhanced to ensure broad notice to all affected parties as soon as possible. In addition, courts and professionals could expand on the concept of a set "comeback date" that would involve a "de novo"

hearing where the legal and practical burden of justifying the contested terms of an order would remain on the applicant.

To the extent the length of the appointment of an interim receiver is a substantive issue, there is nothing precluding an affected party from arguing that term "interim" should be interpreted within the context of the purpose of the appointment. For instance, it could be argued that an interim receiver appointed after the delivery of a section 244 notice, should only be appointed until the expiry of the 10 day period. At that time, arguably the interim receiver should be discharged and the secured creditor's remedy would be to seek the appointment of a traditional receiver.

Notwithstanding the *Big Sky* decision and the upcoming legislative reform, it is likely that interim receivers will play a prominent role in future insolvencies, particularly with the rapid changes in business enterprises, the chaos surrounding business failures and the demonstrable success of this flexible and responsive mechanism.

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\* Partner, Fraser Milner Casgrain LLP

\*\* Associate, Fraser Milner Casgrain LLP

<sup>1</sup> *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended

<sup>2</sup> *Re Big Sky Living Inc.*, [2002] CarswellAlta 875 (Alta. Q.B.)

<sup>3</sup> *Canada v. Curragh Inc.*, [1994] CarswellOnt 294 (Ont. Gen. Div.)

<sup>4</sup> *Re T. Eaton Co.*, [1999] CarswellOnt 3100 (Ont. S.C.J.) [Commercial List]

<sup>5</sup> *Bulk Sales Act*, R.S.O. 1990, c. B.14

<sup>6</sup> *Harris Trust & Savings Bank v. Anicom Multimedia Wiring Systems Inc.*, [2001] CarswellOnt 819 (Ont. S.C.J.) [Commercial List]

<sup>7</sup> *Bruce Agra Foods Inc. v. Proposal of Everfresh Beverages Inc. (Receiver of)* (1996), 45 C.B.R. (3d) 169 (Ont. Gen. Div.)

<sup>8</sup> *Companies' Creditors Arrangement Act* R.S.C. 1985, c.C-36, as amended