The Canadian Recognition of Foreign Insolvency Proceedings:

Comity, Public Policy and Judicial Discretion

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**Introduction**

With no omnipotent international body or set of universal legal rules to govern the relations between parties to international business transactions, comity arguably serves as the principle upon which private international law is predicated. Canadian courts have defined comity as “the deference and respect due by other states to the actions of a state legitimately taken within its territory”¹ and have generally been inclined to recognize and enforce the judgments of foreign courts. Notwithstanding this apparent emphasis on judicial cooperation, Canadian courts may be reluctant to adhere to the principle of comity in cases where the legal regime in question varies significantly from its Canadian counterpart and the interests of Canadian nationals are disproportionately prejudiced.

Cases involving cross-border insolvency epitomize the clash between international comity on the one hand and national sovereignty on the other. Given that the insolvency of an international commercial party almost invariably incites disputes between self-interested creditors from around the world, foreign insolvency judgments are often contested by a disgruntled creditor whose debts have not been satisfied in full. The situation is further complicated by the fact that insolvency laws may vary from one jurisdiction to another. Such issues have prompted international attempts to harmonize the domestic insolvency legislation of sovereign states, most notably through the adoption of the *Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law*² (“Model Law”). Canada has recently given effect to the *Model Law* in 2009 through amendments to its principal

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¹ *Morguard Investments Ltd v De Savoye*, [1990] 3 SCR 1077 [*Morguard Investments*].

insolvency statutes, the Companies’ Creditors Arrangement Act\(^3\) (“CCAA”) and the Bankruptcy and Insolvency Act\(^4\) (“BIA”).\(^5\)

Each of the CCAA and the BIA contains a provision, aptly called the public policy exception, which allows a court to refuse to recognize a foreign insolvency proceeding if doing so would be contrary to public policy.\(^6\) Given Canada’s recent adoption of the Model Law, it remains to be seen under what circumstances the Canadian courts would be unwilling to recognize a foreign proceeding under the CCAA or the BIA on public policy grounds. The purpose of this paper is to analyze the Canadian recognition of foreign insolvency proceedings and, more specifically, the court’s power to refuse to recognize a foreign proceeding if the proceeding is contrary to public policy. To begin, a brief overview of the statutory framework for recognition will be provided. The paper will then turn to an analysis of the public policy exception. By examining pre-amendment and relevant American case law, this paper will attempt to predict what types of foreign insolvency proceedings may be so offensive that they are deemed to be contrary to public policy. It will ultimately be argued that the public policy exception has the potential to be abused and should only be invoked in extreme circumstances where the insolvency regime in question varies significantly from that of Canada or the interests of Canadian nationals are disproportionately prejudiced.

\(^3\) RSC 1985, c C-36, as amended to January 1, 2010 [CCAA].
\(^4\) RSC 1985, c B-3 [BIA].
\(^5\) The Winding-up and Restructuring Act, RSC 1985, c W-11 [WURA] governs the winding-up and liquidation of foreign banks and insurance companies, \textit{inter alia}. A foreign bank or insurance company wishing to have claims stayed against it in Canada must apply for protection under Parts II and III respectively. Given that the WURA does not contain an express public policy exception, it will not be addressed in this paper. However, it is important to note that, after an application for a winding-up order is made, the court retains discretion to make any order it deems appropriate. This means that the court can refuse to stay proceedings against a foreign bank or insurance company if doing so would be contrary to Canadian public policy. As a result, this paper’s predictions with respect to the circumstances under which a Canadian court would be unwilling to recognize a foreign insolvency proceeding on public policy grounds under the CCAA or BIA apply equally to the WURA.
\(^6\) CCAA, \textit{supra} note 3, s 61(2); BIA, \textit{supra} note 4, s 284(2).
The Recognition of Foreign Insolvency Proceedings under the *CCAA* and the *BIA*

Through its adoption of the *Model Law* in 2009, the Canadian Parliament took significant steps towards achieving an insolvency regime more capable of equitably and efficiently administrating international insolvencies. This section will provide a brief overview of the statutory procedure that must be followed under Part IV of the *CCAA* and Part XIII of the *BIA* in order to have a foreign insolvency proceeding recognized in Canada.

To commence the process, a foreign representative must apply to the court for recognition of a foreign insolvency proceeding.\(^7\) If the applicant is successful in convincing the court that he or she is a “foreign representative” and that the application relates to a “foreign proceeding” as those terms are defined under the *CCAA* and the *BIA*, the court must make an order recognizing the foreign proceeding.\(^8\) Both terms are to be given a broad and purposive interpretation thereby allowing an applicant to meet the requirements for recognition of a foreign proceeding without difficulty.\(^9\)

Once the court is satisfied that applicant is a foreign representative and that the application relates to a foreign proceeding, the court must determine whether the foreign proceeding is a “foreign main proceeding” or a “foreign non-main proceeding”.\(^10\) The consequence of this classification is a vital one as it defines the nature of the relief available to the debtor. If the proceeding is characterized as a foreign *main* proceeding, the court must issue an order staying all proceedings against the debtor, restraining further proceedings in any action

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\(^7\) *CCAA*, *supra* note 3, s 46; *BIA*, *supra* note 4, s 269.

\(^8\) *CCAA*, *supra* note 3, s 47(1); *BIA*, *supra* note 4, s 270(1).

\(^9\) See, for example, *Zayed v Cook*, 2009 Carswell Ont 8079 (SC), where it was held that a United States receivership proceeding in which a receiver was appointed on an *ex parte* basis in connection with alleged securities violations constituted a foreign proceeding.

\(^10\) *CCAA*, *supra* note 3, s 47(2); *BIA*, *supra* note 4, s 270(2).
against the debtor, and prohibiting the debtor of disposing of its assets. On the other hand, if
the proceeding is classified as a non-main proceeding, a stay is not automatic. Rather, the court
has the discretion to make any order necessary for the protection of the debtor’s property or the
interests of creditors.

Both the CCAA and BIA define a “foreign main proceeding” as a foreign proceeding in a
jurisdiction where the debtor has its centre of main interests (“COMI”). By contrast, a “foreign
non-main proceeding” is defined as any foreign proceeding other than a foreign main
proceeding. While neither statute provides an exhaustive set of factors that should be
considered to determine a debtor’s COMI, there is a rebuttable presumption that an insolvent
company’s COMI is located in the jurisdiction of its registered office. Notwithstanding this
statutory guidance, the Canadian courts have considered the COMI issue on several occasions
since the adoption of the Model Law. This has resulted in a comprehensive set of COMI
considerations that can be applied to determine whether a foreign proceeding is a main
proceeding. Such factors include the location where the debtor carries on its business, the

11 CCAA, supra note 3, s 48(1); BIA, supra note 4, s 271(1).
12 CCAA, supra note 3, s 49(1); BIA, supra note 4, s 272(1).
13 CCAA, supra note 3, s 45(1); BIA, supra note 4, s 268(1).
14 Ibid. It is important to note that the Canadian legislature elected not to adopt the definition of “foreign non-main
proceeding” proposed by the Model Law. Article 2(c) of the Model Law defines a “foreign non-main proceeding” as
a foreign proceeding other than a foreign main proceeding which takes place in a jurisdiction where the debtor has
Code”), the US equivalent to Part IV of the CCAA, adopted the definition of “foreign non-main proceeding”
proposed by the Model Law. At first glance, Parliament’s omission of an establishment requirement seems
significant. If a foreign insolvency proceeding is not a foreign main proceeding and the debtor has no establishment
in the foreign jurisdiction, a US court will not recognize the proceeding while a Canadian court may. What follows
is that Canadian courts may recognize more foreign proceedings than US courts. See Scott A Bomhof and Pamela
LJ Huff, “Comparison between Chapter 15 of U.S. Bankruptcy Code, and Part IV of Companies’ Creditors
Arrangement Act” (Paper delivered at the American Bankruptcy Institute: Canadian-American Insolvency
Symposium 2011, Toronto, 7 November 2011), [unpublished] at 3. However, it must be remembered that, once a
proceeding is classified as a foreign non-main proceeding, a Canadian court has the discretion to make any order it
deems fit, meaning that it is not obliged to make any order at all. As a result, the fact that the Canadian legislature
chose to define a foreign non-main proceeding in a manner that differs from the Model Law is likely moot.
15 CCAA, supra note 3, s 45(2). In the case of an individual debtor, section 268(2) of the BIA deems the debtor’s
ordinary place of residence to be his or her COMI.
jurisdiction in which the debtor is subject to controls and regulations, the location where the
debtor holds its employees and key assets, and the jurisdiction in which the debtor’s key
stakeholders are located.16

The COMI case law has revealed an overwhelming trend in favour of recognizing foreign
insolvency proceedings as foreign main proceedings. Canada’s adoption of the Model Law can
thus be understood as having given rise to an era of international judicial cooperation. Despite
this patent willingness to defer to the decisions of a foreign court where the circumstances justify
it, it must be remembered that Canadian courts retain the discretion to refuse to recognize a
foreign insolvency proceeding if doing so would be contrary to public policy.17 The next section
will attempt to define the scope of the public policy exception.

The Public Policy Exception: Domestic Law Sword or Shield?

Each of Part IV of CCAA and Part XIII of the BIA contains a public policy exception which
permits the court to “refus[e] to do something that would be contrary to public policy.”18 Any
attempt to predict the nature of the public policy exception under Part IV of the CCAA and Part

16 Re Gyro-Trac (USA) Inc, 2010 CarswellQue 2952, 2010 QCCS 1311, [2010] RJQ 1145 at para 97. See also Re
Probe Resources Ltd, 2011 CarswellBC 1043, 2011 BCSC 552, [2011] BCWLD 4722 (SC) and Re Massachusetts
17 CCAA, supra note 3, s 61(2); BIA, supra note 4, s 284(2).
18 Ibid. This provision is to be contrasted with the public policy exception proposed in Article 6 of the Model Law,
which suggests that the public policy exception should be reserved for actions that would be manifestly contrary to
the public policy of a particular state. The US Bankruptcy Code adopted the version of the public policy exception in
the Model Law. According to section 89 of the Guide to Enactment of the UNCITRAL Model Law on Cross-Border
Insolvency, 1997 XXVIII UNCITRAL YB pt 3, UN Doc A/CN 9/422 [Guide to Enactment], the purpose of the
word “manifestly” to qualify the term “public policy” is to emphasize that the exception should be interpreted
restrictively and should only be invoked “under exceptional circumstances concerning matters of fundamental
importance for the enacting State.” The obvious implication is that Canadian courts may apply the public policy
exception more liberally than was intended by the Model Law. This paper does not seek to advance such a
conclusion as it would be unfounded at this time. The point being made is that it could be contended that US case
law is of somewhat limited precedential value given the differences between the Canadian and US legislation.
However, recent statements made in obiter citing the Guide to Enactment as authority for the proposition that
the exception ought to be interpreted restrictively suggest that Canadian courts will approach the public policy exception
in much the same manner as their US counterparts. See, for example, Morawetz J’s comments in Re Hartford
Computer Hardware Inc, 2012 CarswellOnt 2143, 2012 ONSC 964 at para 17. What follows is that it is appropriate
to refer to American jurisprudence for guidance in determining the nature of the public policy exception in Canada.
XIII of the BIA would be incomplete without a brief summary of the principles followed by Canadian courts in cases involving international comity and public policy more generally. In Morguard Investments, the Supreme Court of Canada recognized comity’s prevalence in the context of modern commerce. The Court held that comity is an idea based not only on respect between sovereign states; it is a necessary prerequisite for the reciprocal flow of communication, skills and capital in a cosmopolitan commercial world. In other words, with the exception of foreign judgments that may be contrary to Canadian public policy, Canadian courts will likely be inclined to recognize foreign judgments – particularly those of key jurisdictions such as the United States – simply because they want Canadian judgments to be enforced abroad. It is important to keep in mind this desire for judicial reciprocity as a theme underlying a court’s decision to recognize a foreign proceeding. As will become evident from the case law below, the courts are generally loath to employ the public policy exception unless extreme circumstances warrant its invocation.

Canadian Imperial Bank of Commerce v ECE Group Ltd serves as a rare example of a pre-amendment Canadian case in which the Ontario Superior Court of Justice refused to grant a stay in recognition of a liquidation proceeding commenced under the US Bankruptcy Code on grounds of public policy. In this case, although the debtor corporation was the nominal moving party, the motion was actually brought by insurance carriers attempting to escape potential liability arising out of claims in Ontario. The US order directed the insurance carriers to pay $2.9 million in exchange for a stay of all claims against the debtor corporation and the insurance carriers. In his ruling, Farley J recognized that, although Canadian courts have traditionally been strong supporters of comity and the recognition of foreign orders, the existence of comity is not

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19 Morguard Investments, supra note 1 at para 30.
20 2001 CarswellOnt 463; 23 CBR (4th) 92 [ECE Group].
limitless; comity must not be exercised at the expense of injustice to a country’s citizens.\footnote{Ibid at paras 10 and 11.} Because the evidence surrounding the proceeds was equivocal, it was not clear that the interests of Canadian creditors were being taken into account under the US plan.\footnote{Ibid at para 12.} Although his reasons for judgment were brief, there are indications that Farley J’s decision to refuse to grant the stay may have been influenced by the fact that motion was brought by insurance carriers and not the debtor corporation.\footnote{Ibid at para 15.} In any event, \textit{ECE Group} is a pre-amendment public policy case where a Canadian court refused to recognize a foreign order on the basis that it may have been unduly prejudicial to the interests of Canadian creditors.

Unlike Canadian courts, American courts have had the opportunity to explore the public policy exception on several occasions since the US adoption of the \textit{Model Law} in 2005. \textit{In re Ephedra Products Liability Litigation}\footnote{349 BR 333 (SDNY 2006) [\textit{In re Ephedra}].} was among the first public policy cases decided by an American court. It is of particular significance given its Canadian connection. Muscletech Research and Development, Inc. (“Muscletech”) was a Canadian company which used ephedra in a number of its products. After the United States Food and Drug Administration issued a warning that it intended to ban ephedra in six months, over 30 product liability actions were brought against Muscletech and others involved in the manufacture and distribution of Muscletech’s products. Muscletech commenced an insolvency proceeding in Ontario and sought relief under the \textit{CCAA}. A claims resolution procedure was negotiated pursuant to which certain third parties agreed to fund the settlement of the product liability actions in exchange for a release of Muscletech and all third parties. The plan was approved by the Ontario Superior Court of Justice and Muscletech sought to have the plan recognized as a foreign main proceeding under
Chapter 15 of the US *Bankruptcy Code*. Four American claimants involved in the product liability actions opposed recognition of the plan on the basis that it was manifestly contrary to the public policy of the United States because it deprived them of their constitutional right to a trial by jury.25

In ruling that the Canadian plan was not contrary to public policy, Judge Rakoff of the United States District Court for the Southern District of New York (“SDNY”) held that the public policy exception must be narrowly interpreted and reserved for “the most fundamental policies of the United States.”26 Moreover, Judge Rakoff found that the claimants’ position ultimately amounted to an argument that the Canadian plan left them with less of a bargaining position than in a jury trial. Given that the claimants were still provided with a fair and impartial hearing under the Canadian plan, such a deprivation did not rise to the level of fundamental unfairness.27 *In re Ephedra* can be seen to stand for the proposition that, barring situations where a creditor is disproportionately prejudiced or there is a significant difference between the insolvency laws of two jurisdictions, considerations of comity generally trump those of domestic law in a cross-border insolvency.

The SDNY came to a similar conclusion in *In re Ashapura Minechem, Ltd.*28 In this case, a foreign representative brought a motion to have an Indian administrative proceeding recognized as a foreign main proceeding under Chapter 15 of the US *Bankruptcy Code*. The complicating factor was that the Indian statute underlying the administrative proceeding had since been repealed on the basis that it was fundamentally flawed and subject to abuse. However, no implementing legislation had been enacted and so the administrative proceeding was to be

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26 *Ibid* at 337.
27 *Ibid*.
28 2011 WL 5855475 (SDNY 2011) [*In re Ashapura*].
governed by the repealed version of the statute. Certain unsecured creditors opposed recognition of the proceeding on public policy grounds, arguing that the existing version of the legislation had been repealed as a result of its deficiencies.\textsuperscript{29} The decision focused on the availability of appellate review and potential for unsecured creditors to receive distributions as evidence that the repealed legislation provided for unsecured creditor participation, albeit through limited and discretionary means.\textsuperscript{30} The fact that unsecured creditors were not as involved in the Indian proceeding as they would have been in an analogous case under the US \textit{Bankruptcy Code} was an insufficient basis upon which to invoke the public policy exception. As in \textit{In re Ephedra}, a mere difference between the insolvency laws of two jurisdictions did not warrant relief where the interests of creditors were not \textit{unduly} prejudiced. The ruling in this case reinforces the notion that the public policy exception is reserved for matters of fundamental importance to the state in question. Where such a threshold is not met, the principle of comity should prevail.

\textit{In re Qimonda AG}\textsuperscript{31} is a rare example where an American court felt it necessary to employ the exception to protect the interests of American creditors. This case involved a German corporation, Qimonda AG ("Qimonda"), which manufactured semiconductor memory devices. Prior to its insolvency, Qimonda had granted patent licences to several large international companies including Samsung Electronics Co., Ltd., International Business Machines Corp. and Intel Corporation, \textit{inter alia}. Qimonda elected to terminate its US licences pursuant to the provision under the relevant German insolvency legislation permitting a debtor to reject its executory contracts. The German legislation does not contain any equivalent provision to section 365(n) of the US \textit{Bankruptcy Code}, which allows a licencsee of intellectual property to retain its

\textsuperscript{29} \textit{Ibid} at 3.
\textsuperscript{30} \textit{Ibid} at 7.
\textsuperscript{31} 462 BR 165 (ED Va 2011) [\textit{In re Qimonda}].
rights under a licence agreement notwithstanding the debtor’s rejection of the licence.\(^{32}\) The US order recognizing the German proceeding confirmed the applicability of section 365(n), thereby allowing the US licencees to retain their rights under the licence agreements. The foreign representative brought a motion to remove the reference to section 365(n) from the order.

In denying the relief sought, the Eastern District Court of Virginia held that US licencees would not be “sufficiently protected” if they were not afforded the protections provided by section 365(n) of the US *Bankruptcy Code*.\(^{33}\) The Court recognized that the fact that a foreign law differs from an America law was *per se* insufficient to deny comity; the public policy exception could only be invoked if the effect of the German law was to defeat "the most fundamental policies and purposes" of a licensee’s right to continue using a patent licence during a licensor’s insolvency.\(^{34}\) Ultimately, it was held that deferring to German insolvency law in this instance would undermine a fundamental US public policy and the foreign representative’s motion was denied.\(^{35}\) This case serves as an extreme example where a foreign jurisdiction’s insolvency laws differed so radically from those of the United States that the interests of American creditors would have been substantially prejudiced if the motion had been granted. *In re Qimonda AG* thus sets a worthy precedent for Canadian courts considering the public policy exception in the future.

A cursory reading of the controversial body of law provided above seems to suggest that the public policy exception is a flexible tool that can be used to deny recognition of any proceeding originating in a jurisdiction whose insolvency laws differ from those of Canada. Nevertheless, a more nuanced review of these American and pre-amendment Canadian cases

\(^{32}\) US *Bankruptcy Code*, supra note 14, § 365(n).

\(^{33}\) *In re Qimonda*, supra note 31 at 182 and 183.

\(^{34}\) *Ibid* at 184.

\(^{35}\) *Ibid* at 185.
reveals a pattern of judicial reluctance to employ the public policy exception unless extreme circumstances warrant its invocation. The fact that the insolvency laws of two jurisdictions differ is generally insufficient, as is a creditor’s argument that she has been deprived of some of the procedural protections available to her under her country’s domestic insolvency legislation. Rather, the public policy exception must only be invoked in cases where the discrepancy between the insolvency laws of two jurisdictions is so significant that it has the effect of causing disproportionate prejudice to the rights of national creditors.

**Conclusion**

As international commercial litigation continues to proliferate, the clash between international comity on the one hand and national concerns on the other becomes all the more patent. A review of the statutory scheme underlying the recognition of foreign insolvency proceedings has verified that, at least in the context of cross-border insolvencies, the principle of comity generally prevails. There is a clear emphasis on judicial cooperation in the American and pre-amendment Canadian case law related to the public policy exception. The conclusion that can thus be gleaned is that Canadian courts will likely reserve the public policy exception for extreme circumstances in which the insolvency laws of the foreign jurisdiction differ to such an extent from Canadian law that the interests of Canadian creditors are unduly prejudiced.

Although courts have exercised self-restraint in applying the public policy exception since the adoption of the *Model Law*, it must be remembered that the exception is a powerful judicial tool which has the potential to be abused. Despite comity’s recent triumphs, there is a danger that the public policy exception will be used as a means to curb the legitimate exercise of a foreign court’s jurisdiction. When can a legal system be said to diverge *radically* from that of Canada?
What constitutes a matter of such *fundamental importance* that it rises to the level of a Canadian public policy? These questions are extremely difficult to answer and must not be taken lightly by Canadian courts considering whether to invoke the public policy exception in the future.