THE CANADIAN BAR ASSOCIATION
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February 7, 2005

The Honourable Senator Joan Fraser
Chair
The Standing Senate Committee on
Transport and Communications
The Senate
Ottawa ON K1A 0A4

Dear Senator Fraser:

Re: Bill C-4 — *International Interests in Mobile Equipment (aircraft equipment) Act*

I am writing on behalf of the National Bankruptcy and Insolvency Section of the Canadian Bar Association (CBA Section) concerning Bill C-4, *International Interests in Mobile Equipment (aircraft equipment) Act*. The Canadian Bar Association is a national association representing 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

Bill C-4 is intended to implement the *Convention on International Interests in Mobile Equipment* (the *Convention*) and the *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment* (the *Protocol*).

The CBA Section generally supports Canada's ratification of the *Convention* and the *Protocol*. However, we wish to ensure that consideration be given to:

(a) whether the proposed amendments to the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA) are effective to implement the intended policy objective;

(b) the impact of the proposed amendments to the BIA and the CCAA on the affected stakeholders;

(c) the impact of certain declarations that Canada may make under the *Convention* and *Protocol* on insolvency law and practice in Canada; and

(d) whether amendments to the Canadian insolvency regime ought to take place outside of the on-going insolvency reform process.

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The CBA Section's recommendations are as follows:

Amendments to the BIA and the CCAA

- Section 65.1 of the BIA should be amended to deal with true leases of aircraft objects.
- Section 69.3 of the BIA should provide that additional conditions must be imposed by the court where an order is made under subsection 69.3(2) suspending the rights of a secured creditor with security over aircraft objects from enforcing its security.
- Provisions should be added to Parts XI and Part II of the BIA restricting the ability of the court to make orders in the context of a receivership or interim receivership that would allow a receiver or interim receiver to continue the use of aircraft objects except in accordance with the same restrictions imposed on a reorganizing debtor to use aircraft objects in a reorganization.
- The amendments to sections 69 and 69.1 of the BIA should refer to "secured creditors who hold security on aircraft objects". Section 2 of the BIA defines secured creditor very broadly and would include a creditor holding security on aircraft objects.
- Section 11.31 should read: "No order under section 11 prevents a secured creditor who holds security on aircraft objects or a lessor of aircraft objects under an agreement with a debtor company…".

Declarations under the *Convention* and *Protocol*

- The CBA Section recommends that the exercise of remedies by secured creditors with security over aircraft objects be subject to Part XI of the BIA. This could require that Canada file a declaration under Article 54 of the *Convention* to the effect that, without leave of the court, no remedy may be exercised except in accordance with Part XI of the BIA.
- We recommend that Article XII not be applicable in Canada and that subsection 4(2) of Bill C-4 be amended to include reference to Article XII of the *Protocol.*
- The CBA Section recommends that Bill C-4 not come into force until it is determined which, if any, non-consensual interests and rights of arrest or detention will have priority over interests registered under the Convention.

The CBA Section has prepared a detailed submission which is enclosed. We trust that these and other comments in our submission will be taken into consideration by the Committee in its deliberations.

Yours truly,

(*Original signed by Trevor Rajah on behalf of Deborah Grieve*)

Deborah Grieve
Chair
National Bankruptcy and Insolvency Section

Encl.

Bill C-4 — *International Interests in Mobile Equipment (aircraft equipment) Act*

NATIONAL BANKRUPTCY AND INSOLVENCY SECTION
CANADIAN BAR ASSOCIATION

February 2005

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PREFACE

The Canadian Bar Association is a national association representing 38,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Bankruptcy and Insolvency Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Bankruptcy and Insolvency Section of the Canadian Bar Association.

Bill C-4 — *International Interests in Mobile Equipment (aircraft equipment) Act*

I. INTRODUCTION

The National Bankruptcy and Insolvency Section of the Canadian Bar Association (CBA Section) is pleased to present this submission to the Senate Standing Committee on Transport and Communications on Bill C-4, *International Interests in Mobile Equipment (aircraft equipment) Act*.

Bill C-4 is intended to permit the implementation of the *Convention on International Interests in Mobile Equipment* (the *Convention*) and the *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment* (the *Protocol*).

Bill C-4 was introduced in the House of Commons on October 8, 2004 and passed on November 15 with only minor amendments. Canada was an active participant in the negotiation of the *Convention* and *Protocol* and signed the *Convention* and *Protocol* on March 31, 2004.

The purpose of the *Convention* is to facilitate and encourage asset-based lending. The *Convention* establishes a legal regime for the creation, enforcement, perfection and priority of "international interests" — security interests or lease interests with defined rights — in three categories of high-value, uniquely-identifiable mobile equipment: aircraft equipment; rolling stock; and space property.

Priority between international interests will be established when the holder of the interest files notice of its interest in an international registry. The *Protocol* implements the *Convention* with respect to aircraft objects — airframes, aircraft engines and helicopters above a minimum size or power threshold.

The implementation of the *Convention* and the *Protocol* has the potential to impact insolvency law practice in Canada. In addition, Bill C-4 makes consequential amendments to the *Bankruptcy and Insolvency Act* (the BIA) and the *Companies' Creditors Arrangement Act* (the CCAA).

The CBA Section generally supports the ratification of the *Convention* and the *Protocol* by Canada, but is concerned that proper consideration be given to:

(a) whether the proposed amendments to the BIA and the CCAA are effective to implement the intended policy objective;

(b) the impact of the proposed amendments to the BIA and the CCAA on the affected stakeholders;

(c) the impact of certain declarations that Canada may make under the *Convention* and *Protocol* on insolvency law and practice in Canada; and

(d) whether amendments to the Canadian insolvency regime ought to take place outside of the on-going insolvency reform process.

II. AMENDMENTS TO THE BIA AND THE CCAA

Bill C-4 proposes a number of amendments to the BIA and the CCAA. These amendments are intended to give persons who finance or lease aircraft objects the ability to exercise their remedies in an insolvency proceeding unless the debtor or the insolvency administrator:

(a) maintains the aircraft object in accordance with the applicable agreement; and

(b) within 60 days of the commencement of the insolvency proceeding, cures all defaults under the applicable agreement (except insolvency defaults) and ensures that no new defaults occur (except insolvency defaults).

In the case of the BIA, Bill C-4 seeks to accomplish this objective by imposing limitations on the automatic stay of proceedings that prevents creditors from exercising their remedies in the context of a reorganization or bankruptcy. In the case of the CCAA, Bill C-4 seeks to accomplish the objective by limiting the scope of the stay of proceedings that the court can impose when proceedings are commenced under the Act.

The proposed amendments to the BIA and the CCAA can be traced to Article XI of the *Protocol*. Article XI is intended to provide protection to persons who finance or lease aircraft objects by imposing restrictions on the right of a debtor or insolvency administrator to continue to use aircraft objects after insolvency proceedings have been commenced.

Article XI is not a mandatory provision and is pertinent only if a Contracting State makes a declaration making it applicable. Where Article XI is not adopted, the Contracting State can make any provision it wishes in its domestic insolvency laws on the treatment of security and lease interests in aircraft objects. Where Article XI is adopted, the Contracting State must chose between one of two alternative methods of restricting the rights of debtor or insolvency administrators to use aircraft objects in an insolvency proceeding.

Canada has formally elected not to implement Article XI of the *Protocol*. Canada has, however, chosen to amend the BIA and the CCAA in an attempt to ensure that in insolvency proceedings in Canada, the treatment of persons financing or leasing aircraft objects will be consistent with Article XI. Canada has chosen to include provisions in the BIA and the CCAA that parallel Alternative A of Article XI. This alternative is, in

turn, parallel to section 1110 of the *United States Bankruptcy Code* (the USBC). This provision of the USBC applies to the treatment of persons with security and lease interests in aircraft objects and ships in insolvency proceedings involving airlines and shipping companies. There is little practical difference between the treatment of persons who have security or lease interests in aircraft objects under Alternative A of Article XI and section 1110 of the USBC.

Section 1110 of the USBC creates an exception to the stay of proceedings that arises when an insolvency proceeding is commenced. In the case of an insolvency proceeding involving an airline, the airline has 60 days to decide whether it will continue to use the aircraft objects subject to a security or lease interest. During this 60-day period the airline must comply with the terms of the applicable agreement. If the airline wishes to retain the use of the aircraft object, it must cure all defaults under the applicable agreement and ensure that no defaults arise under the agreement. The court has no jurisdiction to extend the 60-day period.

The CBA Section understands that the choice to parallel the USBC provisions was driven by the fact that better financing and lease terms are available to purchasers and lessees of aircraft objects in countries whose laws parallel section 1110 of the USBC. Canada's adopting parallel legislation will, the CBA Section understands, result in significant savings to Canadian aircraft purchasers and lessees.

A. Implementation Issues

The CBA Section is concerned that Bill C-4, as presently drafted, may not have the effect of fully implementing the intended objectives underlying amendments to the BIA and the CCAA. Additional amendments to the BIA and the CCAA may be required.

i. Reorganizations

a) *Bankruptcy and Insolvency Act*

The intent of the proposed amendments to sections 69.1 and 69.3 of the BIA is to restrict the ability of a reorganizing debtor to use aircraft objects that are subject to both security interests and lease agreements. The proposed amendments do not fully accomplish the objective. The objective is accomplished with respect to security interests over aircraft objects but not with respect to leases. Additional amendments to the BIA are required to deal with leases of aircraft objects.

Following the model of the USBC, Bill C-4 attempts to deal with both security interests and lease agreements as exceptions to the automatic stay of proceedings on commencement of a reorganization. This may not be appropriate, given the differences between the structure of the USBC and the BIA reorganization regime.

Unlike the USBC, the automatic statutory stay in sections 69 and 69.1 of the BIA deals only with the rights of secured and unsecured creditors to enforce claims against the debtor. The ability of parties to contracts with the debtor to terminate those contracts is dealt with in section 65.1 of the BIA. In order to effectively restrict the rights of a reorganizing debtor to deal with leased aircraft objects, an amendment to section 65.1 of the BIA is required.

RECOMMENDATION

The CBA Section recommends that amendments be made to section 65.1 of the BIA to deal with true leases of aircraft objects.

b) *Companies' Creditors Arrangement Act*

Subject to the drafting issues addressed below, the intended objective of Bill C-4 is met by amending the one provision of the CCAA. When a reorganization is commenced

under the CCAA, the court relies on section 11 of the CCAA to both stay secured creditors from enforcing their security and to prevent equipment lessors from terminating equipment leases. In this respect, the CCAA is analogous to the USBC.

ii. Liquidations

a) Bankruptcy

The proposed amendment to section 69.3 of the BIA may not reflect the actual position of secured creditors in a bankruptcy.

The automatic statutory stay that arises when a bankruptcy is commenced does not automatically prevent a secured creditor from enforcing its security. If a bankruptcy trustee wishes to retain the use of a secured creditor's collateral, the trustee must apply to the court for an order suspending the secured creditor's right to enforce under subsection 69.3(2).

The proposed BIA subsection 69.3(3) may create confusion on the status of secured creditors with security over aircraft objects. The CBA Section recommends that subsection 69.3(2) be made subject to a new section 69.3(3), which would provide that where an order is made under subsection 69.3(2) in respect of a secured creditor who holds security over aircraft objects, additional conditions must be imposed by the court.

RECOMMENDATION

The CBA Section recommends that section 69.3 of the BIA provide that additional conditions must be imposed by the court where an order is made under subsection 69.3(2) suspending the rights of a secured creditor with security over aircraft objects from enforcing its security.

The proposed amendments to section 69.3 would not impact leases of aircraft objects. Subsection 69.3(1) of the BIA stays the rights of unsecured creditors from taking or

continuing proceedings to recover a claim provable in bankruptcy. Subsection 69.3(2) provides a limited suspension of the rights of secured creditors to enforce their security. Section 69.3 does not, however, deal with the ability to terminate executory contracts. No provisions in the BIA deal with this issue.

Practically, it is rare for a bankruptcy trustee to operate the bankrupt's business. As a result, amendments to the BIA to restrict a bankruptcy trustee's ability to use leased aircraft objects may not be required.

This issue may be an issue that is dealt with in the on-going insolvency reform process and the matter may have to be re-addressed.

b) Receivership/Interim Receivership

Bill C-4 contains no provisions on receivers or interim receivers. This fails to reflect the common use of receivers and interim receivers to effect the going-concern sale of a debtor's assets:

(a) Receivers can be appointed privately by a secured creditor under the terms of a security agreement, or by the court pursuant to provincial or territorial legislation such as the *Courts of Justice Act* (Ontario).

(b) Interim receivers can be appointed by the court pursuant to the BIA.

In the case of a privately-appointed receiver, no stay of proceedings arises that would prevent parties to executory contracts from terminating agreements with a debtor[1] or preventing secured creditors from taking steps to enforce their security under the security agreement. In the case of a security or lease interest in an aircraft object, the private appointment of a receiver would not affect the ability to terminate the lease or enforce the security interest.

1 Provided they were entitled to do so in accordance with the terms of the agreement.

In the case of a court-appointed receiver or interim receiver, the receiver is often authorized by the court to operate the debtor's business while the business and assets are marketed for sale. The court may:

(a) restrict the ability of equipment lessors to terminate leases, provided the receiver or interim receiver continues to make payments owing.

(b) stay secured creditors from enforcing their security.

In practice, a receivership or interim receivership can be very similar to a reorganization in the sense that the debtor's business continues to operate.

Unless restrictions are imposed on the court making orders to stay the termination of leases of aircraft objects or the enforcement of security over aircraft objects, the objective underlying the amendments to the BIA and the CCAA proposed by Bill C-4 will not be fully realized. It would still be possible for the court to impose a stay of proceedings in the context of a receivership or interim receivership that would prevent the termination of leases in respect of aircraft objects and stay the enforcement of security over aircraft objects. This might arise, for example, where a secured creditor over all the debtor's assets seeks the appointment of a receiver or interim receiver to effect a going-concern sale of the debtor's business.

The CBA Section appreciates that constitutional issues arise in federal legislation with respect to receivers appointed pursuant to provincial or territorial legislation. We also note, however, that Parliament has already regulated the conduct of receivers where the debtor is insolvent, under Part XI of the BIA.

RECOMMENDATION

The CBA Section recommends that Parts XI and Part II of the BIA be amended to restrict orders in a receivership or interim receivership that permit a receiver or interim receiver to continue the use of aircraft objects except in accordance with the

same restrictions imposed on the ability of a reorganizing debtor to use aircraft objects in a reorganization.

B. Use of Defined Terms

The amendments proposed to the BIA and the CCAA use terminology that appears to have been derived from the USBC and Article XI of the *Protocol*. This may cause unwarranted confusion. Terms already defined in the BIA and the CCAA should be used instead.

i. *Bankruptcy and Insolvency Act*

The CBA Section is also concerned with the use of the phrase "a creditor who holds security on aircraft objects – or who is a lessor of aircraft objects or a conditional seller of aircraft objects – under an agreement with the insolvent person" in the amendment to sections 69 and 69.1 of the BIA. In the context of the automatic stay under the BIA, the use of this word "creditor" is not appropriate and may cause confusion as to whether a financing lease or conditional sales agreement constitute a creditor as a secured creditor. The term "creditor" is defined in section 2 of the BIA to include both secured and unsecured creditors. "Secured creditor" is also defined and it is generally understood that a financing lease or a conditional sales agreement constitute a creditor as a secured creditor within the meaning of the BIA.

We submit amendments to sections 69 and 69.1 of the BIA ought to refer to secured creditors. If clarification is needed as to whether a financing lease or conditional sales arrangement would constitute a creditor as a secured creditor, the CBA Section recommends that the definition of secured creditor in section 2 of the BIA be amended appropriately.

RECOMMENDATION

The CBA Section recommends that the amendments to sections 69 and 69.1 of the BIA refer to "secured creditors who hold security on aircraft objects". Section 2 of the BIA defines secured creditor very broadly and would include a creditor holding security on aircraft objects.

ii. *Companies' Creditors Arrangement Act*

The proposed section 11.31 introduces a new, undefined, term into the CCAA: "a creditor who holds security on aircraft objects – or a lessor of aircraft objects or a conditional seller of aircraft objects – under an agreement…". Under the CCAA the term "creditor" is not a defined term – the CCAA only contains definitions for secured creditor and unsecured creditor.

RECOMMENDATION

The CBA Section recommends that section 11.31 read: "No order under section 11 prevents a secured creditor who holds security on aircraft objects or a lessor of aircraft objects under an agreement with a debtor company…".

C. Policy Issues

The adoption of provisions parallel to section 1110 of the USBC into Canadian insolvency law will have the effect of significantly enhancing the treatment and position of persons who finance or lease aircraft objects in insolvency proceedings under the BIA and the CCAA when compared to persons who finance or lease other types of equipment.

Section 1110 of the USBC was developed in the context of the treatment of security interests and executory contracts in reorganization and liquidation proceedings. The Canadian insolvency regime does not provide the same treatment to security interests and executory contracts as the USBC. Bill C-4 results in significant differences in treatment that will be afforded to security and lease interests in aircraft objects when compared to security or lease interests in other types of equipment in Canadian insolvency proceedings.

The effect of section 1110 of the USBC (and the intention of Bill C-4) is to provide that the stay of proceedings that prevents parties to executory contracts from terminating their contracts in a reorganization will apply to persons who have leased aircraft objects for only 60 days from the date that reorganization proceedings are commenced. If the debtor wants to retain a leased aircraft object for longer than 60 days, it must either reach an agreement with the lessor or cure all financial defaults under the lease and agree to abide by all of the obligations under the lease going forward.

This does not represent a radical departure from the treatment afforded by the USBC to persons who lease other types of equipment. In a reorganization, under the USBC, the debtor must determine if it wishes to assume or reject executory contracts such as equipment leases. If the decision is taken to assume an equipment lease, the debtor is required to cure all financial defaults under the lease and agree to abide by the terms of the lease going forward. Where the debtor or insolvency administrator decides to reject a lease, the lessor's claim will be unsecured against the estate. The USBC imposes a time limit on the decision to assume or reject an executory contract, but the court may extend this time limit.

The Canadian insolvency regime is quite different from the U.S. insolvency regime in the way that it deals with executory contracts such as leases. In a reorganization, under the CCAA, for example, parties to executory contracts such as equipment leases are

typically stayed from terminating their contracts. This is similar to reorganizations under the USBC, but this is where the similarities end between the two regimes. In a CCAA reorganization, the reorganizing debtor is typically given the right to reject equipment leases, but does not have to assume an equipment lease and cure financial defaults in order to retain the use of the leased equipment. All financial defaults under the lease, as at the commencement of the reorganization, are claims provable against the debtor in the reorganization proceeding.

III. DECLARATIONS UNDER THE *CONVENTION* AND *PROTOCOL*

The *Convention* and the *Protocol* contemplate that a Contracting State may either deliver "opt-out" declarations, which provide that certain provisions will not apply in that Contacting State or "opt-in" declarations, which provide that certain provisions will apply in the State. Aside from the declaration with respect to the application of Article XI of the *Protocol*, a number of the potential declarations could have a fundamental impact on how the *Convention* and *Protocol* impact insolvency practice in Canada. The CBA Section understands that Canada has not yet made any declarations under the *Convention* or the *Protocol* and that only preliminary consideration has been given to the declarations that Canada will make under the *Convention* and the *Protocol*.

The CBA Section is concerned with the potential adverse consequences of implementing the *Convention* and the *Protocol* without consideration being given to certain declarations that might be made by Canada. The CBA Section submits if Bill C-4 becomes law in advance of certain declarations being made by Canada, there could be an adverse and perhaps unintended impact on insolvency practice in Canada.

A. Enforcement of Security

Chapter III of the *Convention* and Article IX of the *Protocol* deal with the remedies available to aircraft financiers and lessors in the event of default. Article 8 of the

Convention provides that, in the event of a default, an aircraft financier or lessor may:

(a) take possession or control of its collateral;

(b) sell or grant a lease of the collateral; and

(c) collect or receive income or profits arising from the collateral.

Article IX of the *Protocol* expands on and modifies the remedies available in respect of aircraft objects.

Only where the secured creditor proposes to sell or grant a lease of its collateral is the secured creditor required by the *Convention* to provide notice of the exercise of the remedy.[2] The exercise of remedies by a financier or lessor must be exercised in a commercially reasonable manner.

Part XI of the BIA deals with the enforcement of security interests by secured creditors where the debtor is insolvent and is intended to supplement the common law and statutory requirements. One of the key provisions of Part XI is section 244 which requires that a secured creditor who intends to enforce its security deliver a notice to the insolvent debtor. Unless the debtor delivers a signed consent, the secured creditor is then prohibited from taking any steps to enforce its security for 10 days in order to provide the insolvent debtor with an opportunity to consider its options. Where a secured creditor has concerns with respect to its collateral, section 47.1 of the BIA allows the secured creditor to apply to the court to have an interim receiver appointed over its collateral. The combined effect of section 244 and section 47.1 is to balance the interests of the secured creditor and the insolvent debtor.

Under Bill C-4, where there is an inconsistency between the *Convention* or the *Protocol* and any other law, the provisions of the *Convention* and the *Protocol* prevail over the other law to the extent of the inconsistency.[3] The CBA Section is concerned

2 *Convention*, Article 8(4) and *Protocol* Article IX (4).

3 Bill C-4, section 6.

that the remedy provisions of the *Convention* and the *Protocol* may permit a secured creditor with security over the aircraft object to enforce its security without complying with Part XI of the BIA and, in particular, with section 244. Where the security agreement between the secured creditor and the debtor permits the secured creditor to take immediate possession of the aircraft object, the CBA Section is concerned that the effect of section 6 will be to abrogate section 244 of the BIA.

Article 14 of the *Convention* provides that remedies under the *Convention* may only be exercised in conformity with the procedural requirement of the place where the remedy is being exercised. The CBA Section is concerned, however, that Part XI of the BIA, and particularly, section 244, may be interpreted as being substantive rather than procedural in nature.

The exercise of the remedies provided for by the *Convention* and the *Protocol* is subject to a declaration being made to the effect that certain remedies may only be made with leave of the court.[4] Our Section understands that Canada has not yet determined what, if any, declarations will be made under Article 54.

RECOMMENDATION

The CBA Section recommends that the exercise of remedies by secured creditors with security over aircraft objects be subject to Part XI of the BIA. This could require that Canada file a declaration under Article 54 of the *Convention* to the effect that without leave of the court, no remedy may be exercised except in accordance with Part XI of the BIA.

4 *Convention*, Article 54.

B. Cross-Border Insolvency Co-Operation

Contracting States have the option of declaring that Article XII of the *Protocol* will apply in the Contracting State. Article XII (2) of the *Protocol* provides:

> The courts of a Contracting State in which an aircraft object is situated shall, in accordance with the law of the Contracting State, co-operate to the maximum extent possible with foreign courts and foreign insolvency administrators in carrying out the provisions of Article XI.

Article XII (2) of the *Protocol* applies only where a Contracting State has made a declaration to the effect that it will be applied.

The import of Article XII would be to require that Canadian courts co-operate in cases where:

(a) there is an insolvency proceeding in a foreign jurisdiction that is the jurisdiction where the debtor has its head office; and

(b) there are aircraft objects owned or leased by the debtor located in Canada.

To the extent that the foreign jurisdiction has adopted Article XI of the *Protocol*, the Canadian courts would, subject to Canadian law, be obliged to co-operate in enforcing the provisions of Article XI as adopted by the foreign jurisdiction.

The application of Article XII (2) raises a number of issues. It is not clear that "in accordance with the laws of [Canada]", when read in the context of the rest of Article XII (2), means that the courts will retain the discretion to refuse to extend co-operation where the interests of Canadian stakeholders would be adversely impacted by the application of Article XI as adopted by the foreign jurisdiction.

The Supreme Court of Canada, in a recent case involving a maritime vessel,[5] found that while the courts in Canada will extend co-operation in connection with a cross-border insolvency, the interests of Canadian stakeholders must be considered and co-operation

will not be extended where Canadian stakeholders may be adversely impacted by the foreign priority regime. In general terms, that case involved a ship located in Canada owned by a foreign debtor subject to insolvency proceedings in its home jurisdiction. The foreign insolvency administrators took proceedings in Canada to have the ship turned over to them. This was opposed by creditors in Canada, whose priority over the ship under Canadian law would not have been recognized in the foreign proceeding. The Supreme Court of Canada found that the loss of priority in the foreign proceeding was a sufficient basis to refuse to turn the ship over to the foreign insolvency administrators.

The CBA Section notes that Alternative A in Article XI provides for the priority of interests registered under the *Convention* and *Protocol* over all interests except for non-consensual rights or interests covered by a declaration made by the Contracting State. In the context of a cross-border insolvency involving a foreign owner or lessor of aircraft objects, Article XII (2) could be read as requiring Canadian courts extend co-operation in connection with a priority regime established in the debtor's home jurisdiction. This could be prejudicial to the interests of Canadian stakeholders who may be afforded a different priority over the aircraft objects under Canadian law.

The application of Article XII may result in the courts applying a different standard of co-operation with respect to aircraft objects in a cross-border insolvency. The BIA and the CCAA both currently provide for co-operation in cross-border insolvencies, a topic that is being addressed in the context of the on-going reform of the BIA and the CCAA. Neither the BIA and the CCAA, nor the options being considered for adoption by Canada, are entirely consistent with Article XII (2).

5 *Holt Cargo Systems v. ABC Containerline* N.V. (Trustees of), [2001] 3 SCR 907.

RECOMMENDATION

The CBA Section recommends that Article XII not be applicable in Canada and that subsection 4(2) of Bill C-4 be amended to include reference to Article XII of the *Protocol*.

C. Priority of Interests

Under the *Convention*, a Contracting State may declare certain non-consensual rights that would, under the Contracting State's domestic laws, have priority over the rights registered pursuant to the *Convention*[6] and which, if any, of these rights will be registerable under the *Convention*.[7] A non-consensual right or interest has priority over a registered interest only if a declaration is filed.[8] A Contracting State may also declare that the *Convention* does not affect rights to arrest or detain an object for the payment of amounts owing for the services provided.[9]

A number of non-consensual interests arising under provincial, federal and territorial law currently have priority over the interests of secured creditors. Various provincial, federal and territorial legislation contain special provisions that are designed to enhance the collection of certain government claims. These provisions create liens on a debtor's property, permit amounts owing to the debtor be paid directly to the government authority in priority to all other claims and create deemed trusts over the debtor's property. The relative priority of these various interests is dependent on a number of factors including whether a formal insolvency proceeding has been commenced. Generally, government claims rank as unsecured creditors in an insolvency proceeding under the BIA unless the security interest created in respect of the claim is registered. The major exception to this general rule relates to the statutory deemed trust created under federal income tax and social welfare legislation which generally arises in respect

6 *Convention*, Article 39(1)(a).

7 *Convention*, Article 40.

8 *Convention*, Article 39(3).

of unremitted source deductions. Under the *Income Tax Act* (Canada), for example, employers are required to deduct tax from employee salaries and remit that tax to the taxation authority. A statutory deemed trust over all of the debtor's property exists in respect of these remittances that ranks prior to the rights of most secured creditors. This trust is enforceable by taxation authorities in priority to all other classes against the debtor's assets notwithstanding a bankruptcy.

Other provincial and territorial legislation create liens for amounts owing in respect of repair or storage charges. The court may also grant priority charges in the context of a receivership or reorganization. In addition, rights of arrest and detention are created by *Civil Air Navigation Services Commercialization Act* (Canada) in connection with the fees charged by Nav Canada and under the *Airport Transfer (Miscellaneous Matters) Act* in connection with airport user fees.

The CBA Section understands that Canada has not yet determined what, if any, declarations will be made under Articles 39 and 40 of the *Convention*. Given the importance of the public policy objectives underlying the rights provided for under federal and provincial law, the CBA Section strongly suggests that the *Convention* not be implemented until such time as determinations are made as to what, if any, non-consensual interests and rights of arrest or detention will have priority over interests registered under the *Convention*.

RECOMMENDATION

The CBA Section recommends that consideration be given to not bringing Bill C-4 into force until a determination is made with respect to which, if any, non-consensual interests and rights of arrest or detention will have priority over interests registered under the *Convention*.

9 *Convention*, Article 39(1)(b).

IV. ON-GOING INSOLVENCY REFORM

In 1997, amendments to the BIA and the CCAA included a provision that both Acts would be referred to a Committee of Parliament for review five years after coming into force. The task of conducting this review was assigned to the Senate Committee on Banking, Trade and Commerce (Senate Committee).

The Senate Committee commenced hearings on May 7, 2003 and released its report on November 3, 2004, "Debtors and Creditors Sharing the Burden: A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*." In its report, the Senate Committee makes a number of recommendations with respect to amendments to the BIA and the CCAA. The CBA Section understands that Industry Canada is in the process of preparing draft legislation to amend the BIA and the CCAA.

There is overlap between the insolvency aspects of the *Convention* and the *Protocol*, and the on-going insolvency reform process. The CBA Section believes that amendments to the BIA and the CCAA that take place outside of the on-going insolvency reform process may have adverse, and unintended, effects on the consistency of Canada's insolvency laws. Major stakeholder groups such as the Canadian Bar Association, the Insolvency Institute of Canada, the Canadian Association of Insolvency and Bankruptcy Practitioners and the Canadian Bankers Association, to name a few, are actively participating in the on-going insolvency reform process and may not have considered how the adoption of the *Convention* and the *Protocol* might impact their recommendations on general insolvency reform.

The CBA Section submits, to ensure consistency in Canada's insolvency laws, that the insolvency issues of the *Convention* and the *Protocol* be dealt with as part of the on-going insolvency reform process. The insolvency-related provisions of the *Convention*

and the *Protocol* are, for the most part, intended to be implemented by declarations made by Contracting States and need not be implemented by Canada at this point in time.

RECOMMENDATION

The CBA Section recommends that any amendments to the BIA and the CCAA required to implement the *Convention* and the *Protocol* be considered as part of the upcoming reform of Canada's insolvency laws.

V. SUMMARY OF RECOMMENDATIONS

Amendments to the BIA and the CCAA

- The CBA Section recommends that amendments be made to section 65.1 of the BIA to deal with true leases of aircraft objects.

- The CBA Section recommends that section 69.3 of the BIA provide that additional conditions must be imposed by the court where an order is made under subsection 69.3(2) suspending the rights of a secured creditor with security over aircraft objects from enforcing its security.

- The CBA Section recommends that Parts XI and Part II of the BIA be amended to restrict orders in a receivership or interim receivership that permit a receiver or interim receiver to continue the use of aircraft objects except in accordance with the same restrictions imposed on the ability of a reorganizing debtor to use aircraft objects in a reorganization.

- The CBA Section recommends that the amendments to sections 69 and 69.1 of the BIA refer to "secured creditors who hold security on aircraft

objects". Section 2 of the BIA defines secured creditor very broadly and would include a creditor holding security on aircraft objects.

- The CBA Section recommends that section 11.31 read: "No order under section 11 prevents a secured creditor who holds security on aircraft objects or a lessor of aircraft objects under an agreement with a debtor company…".

Declarations under the *Convention* and *Protocol*

- The CBA Section recommends that the exercise of remedies by secured creditors with security over aircraft objects be subject to Part XI of the BIA. This could require that Canada file a declaration under Article 54 of the *Convention* to the effect that without leave of the court, no remedy may be exercised except in accordance with Part XI of the BIA.

- The CBA Section recommends that Article XII not be applicable in Canada and that subsection 4(2) of Bill C-4 be amended to include reference to Article XII of the *Protocol*.

- The CBA Section recommends that consideration be given to not bringing Bill C-4 into force until a determination is made with respect to which, if any, non-consensual interests and rights of arrest or detention will have priority over interests registered under the *Convention*.

On-Going Insolvency Reform

- The CBA Section recommends that any amendments to the BIA and the CCAA required to implement the *Convention* and the *Protocol* be considered as part of the upcoming reform of Canada's insolvency laws.