Osgoode Hall Law Journal

Volume 42, Number 2 (Summer 2004) Article 6

Book Review: Creditor Rights and the Public Interest Restructuring Insolvent Corporations, by Janis Sarra

Stephanie Ben-Ishai
Osgoode Hall Law School of York University, sbenishai@osgoode.yorku.ca

CREDITOR RIGHTS AND THE PUBLIC INTEREST: RESTRUCTURING INSOLVENT CORPORATIONS BY JANIS SARRA (TORONTO: UNIVERSITY OF TORONTO PRESS, 2003) 340 pages.[1]

BY STEPHANIE BEN-ISHAI[2]

Air Canada filed for protection under the *Companies' Creditors Arrangement Act*[3] on April 1, 2003 and the ongoing negotiations surrounding the restructuring of the airline have implications for the public interest. What exactly this interest is, how it should be balanced with the interests of traditional creditors, and who should balance these competing interests have been the subjects of ongoing debate in the media and among bankruptcy practitioners. In *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations*, Janis Sarra suggests that the fluid approach, which has been the hallmark of Canada's reorganization regime, has generally worked effectively to balance multiple stakeholders' interests and the public interest. Sarra makes the case for increased participatory and decision-making rights for non-traditional stakeholders within the existing system, focusing in particular on workers and the reliance interest created by their human capital investment.

Creditor Rights and the Public Interest contributes to the virtually non-existent body of academic work on the CCAA, the Canadian statute enacted in 1933 that provided for the restructuring of insolvent corporations with debt exceeding five million dollars. Recently, the CCAA has emerged as a significant part of Canada's bankruptcy regime. It is a short statute that leaves much of its procedural and decision-making

---

[1] [*Creditor Rights and the Public Interest*].

[2] Assistant Professor, Osgoode Hall Law School, Toronto. The author wishes to thank Iain Ramsay for discussions that produced helpful comments and insights and Jenny Siu for her research assistance.

[3] R.S.C. 1985, c. C-36 [CCAA].

discretion to negotiation between the judiciary, the debtor, and major creditors. Unlike the U.S. regime, the Canadian bankruptcy regime is made up of a patchwork of legislation including the *Bankruptcy and Insolvency Act*,[4] which also provides for the reorganization of insolvent corporations, but does not stipulate a minimum debt requirement.[5]

Sarra provides a clear introduction to both the BIA and the CCAA, attempting to open the debate on Canadian bankruptcy and insolvency policy and reform to insolvency outsiders. The methodology employed by Sarra includes a review of court files and attendance at pre-hearing meetings and hearings in CCAA cases heard by the Ontario Superior Court of Justice, Commercial List between 1998 and 2002. In addition, Sarra interviewed more than sixty individuals in five provinces who were recently involved in CCAA proceedings, including insolvency practitioners, managers, workers, trade union representatives, and judges.

Viewed as an advocacy piece in favor of the existing facilitative role of the judiciary and other intermediaries in the CCAA process, this book is highly effective. It is an excellent platform for vigorous debate on one aspect of Canada's bankruptcy regime, particularly in the context of the current federal parliamentary review of the CCAA and the BIA.[6] The danger of the book lies in the fact that it is the only recent academic commentary on the CCAA and thus may be seen as an authoritative text rather than an advocacy piece.

I. ENTERPRISE VALUE MAXIMIZATION

Sarra embraces an enterprise wealth maximization theory that is based on the premise that a corporation or enterprise is made up of interests broader than those of traditional creditors and shareholders. This theory has been used in a corporate governance context to argue that directors and officers can take a broader set of stakeholder interests into account when fulfilling their corporate mandate. Corporate governance scholars have suggested that the consequences of business failure to stakeholders such as employees and suppliers are serious as these groups

---

[4] R.S.C. 1985, c. B-3, as am. by S.C. 1997, c.12 [BIA].

[5] *Ibid.* Part III, Division I.

[6] The Senate Committee on Banking, Trade and Commerce held hearings on the operation and administration of the BIA and CCAA in the spring of 2003 and issued its report in November 2003. See Report of the Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors' Arrangement Act*, November 2003.

often lack alternative markets for their skills and products.[7] At the same time, these stakeholders can directly affect the profits or losses of the corporation. Accordingly, wealth maximization can only be achieved through the inclusion of human capital and other kinds of firm specific investments in corporate decision-making, rather than simply considering the existing capital claims on the corporation's assets.[8]

Transferring enterprise wealth maximization theory to the bankruptcy and insolvency context, Sarra argues that the reorganization process should be the forum where all such interests can be heard prior to a corporation being restructured. Sarra labels this approach, which transcends the solvency of the corporation, as "enterprise value maximization."

Enterprise value maximization theory is indifferent to whether a corporation should reorganize or liquidate. However, it suggests that decision-makers need to consider a broader range of stakeholder interests. In making the case for greater participatory and decision rights for non-traditional stakeholders, Sarra relies heavily on the observation that despite the fact that shareholders often retain no equity in insolvent corporations, Canadian courts have been unwilling to divest them of decision-making rights during restructuring. Therefore, other interests that are not strictly defined by capital claims should also be accorded participation rights.

Sarra suggests that in a CCAA reorganization, non-traditional stakeholder interests can be divided into two types. The first type, which the law currently recognizes, is capital claims. Capital claims include claims for unpaid wages, vacation pay, tax arrears, orders for environmental clean up, and damages for torts. The second type of claim, which is legally unrecognized, includes firm-specific human capital investments, the cost of environmental harm to future land use and local community dependence on that use, and costs to local creditors and local economies from lost merchant trade. Sarra suggests that this second type of interest has been referred to by Canadian courts in the broad context of the public interest, but has not been formally recognized or quantified. She argues that such equitable claims (not to be confused with equity) need to be quantified and formally recognized in the CCAA process.

This book focuses primarily on workers who are characterized as non-traditional stakeholders in a CCAA reorganization. From this worker

---

[7] Margaret Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, D.C.: Brookings Institute, 1995) at 209-210.

[8] Bernard Black, "Corporate Law and Residual Claimants" (Columbia University School of Law and Economic Studies, 1996) [working paper] at 19, 36 (cited in *Creditor Rights and the Public Interest*, *supra* note 1 at 48).

model, Sarra extrapolates arguments to account for other non-traditional stakeholders. She suggests that workers' equitable claims may be calculated as the present value of what those workers reasonably expected would be the return on their human capital investment had their firm not become insolvent. The value calculated should be translated into voting and participation rights in the restructuring process. Participation would take the form of involvement in negotiations and the court supervised process, as well as the ability to participate in creditor committees. These rights would complement the fixed capital claims for employee contracts and statutory benefits that workers already have under the CCAA. If there is a successful turnaround, even though the value of workers' equitable claims have the potential of being reduced to zero, workers should be entitled to a proportional amount of the value generated in the reorganization in a fashion similar to the treatment of shareholders.

The rationale behind this formula is that, unlike traditional creditors, workers do not have the bargaining power to insist on disclosure of potential firm failure before making contracts. Further, employees cannot easily protect themselves because of informational asymmetries, lack of bargaining power, and limited employment choices; they cannot diversify their investment like a shareholder or raise the cost of credit based on their assessment of risk like a creditor. Also, if the debtor corporation is between collective bargaining negotiations, the corporation is under no statutory obligation to negotiate with the union for additional protection.

In response to traditional creditors who question how her model would benefit them, Sarra suggests that adopting the enterprise value maximization objective would encourage efficient production through enhanced use of organizational capital, reduced informational asymmetries, and reduced agency costs, which would in turn minimize the losses associated with financial distress and reduce the overall costs of capital.

II. RESPONSE TO ENTERPRISE VALUE MAXIMIZATION

A. *Human Capital Investment*

Sarra's goal of taking into account workers' human capital investments in the context of a CCAA restructuring, which has implications for deferred returns in the form of future wages and other benefits, is laudable. However, it is based on an assumption of reliance, which may no longer hold true in today's labour market. Given that the average job

tenure is forty-four months,[9] the extent of workers' reliance on this deferred return on their human capital investment is questionable. Even if one accepts that workers still rely on a deferred return on their human capital investment, a more nuanced understanding of which workers' interests are valued would be helpful.

In both the description and application of Sarra's model in the case studies, it appears that she is making the case for a class of stakeholders whose interests are in fact already included in the existing CCAA scheme. It is unclear why reform efforts should focus on quantifying these workers' interests. In addition, Sarra does not distinguish between different industries and types of workers—for example, those industries that depend more on human capital versus those that depend more on structural capital. In industries that depend most on human capital or talent, workers are clearly in the best position to extract the most profits from the corporation for themselves. Such workers are unlikely to remain loyal to employers and can easily obtain new employment. Accordingly, such workers would be accorded very little in the way of decision and participation rights under Sarra's formula.

At the other end of the spectrum, the structural capital dependent industries that Sarra focuses on appear to be those that are unionized and offer private employer pension plans to their employees. Sarra's case studies suggest that the interests of such workers are already collectivized in two ways. First, such workers are represented by unions, who already value the investments made by workers in the manner that Sarra suggests and accord participation and decision rights in the union. Based on the case studies presented by Sarra, it appears that unions are already gaining recognition in the context of CCAA proceedings beyond what their fixed capital claims would accord them. Second, as courts become increasingly willing to allow for shareholder participation in a CCAA restructuring process, their interests are again collectively represented. As Sarra points out, North America's largest shareholders are the pension funds, which largely invest the savings of these same workers.

Sarra's analysis and formula may be increasingly useful in the context of the thousands of BIA proposals each year that implicate the interests of non-unionized low-wage workers employed by smaller corporations that do not offer private employer pension plans. Such

---

[9] Statistics Canada, *The People, Job Tenure* (Canada: Statistics Canada, 2003), online: Canada e-Book <http://142.206.72.67/02/02e/02e_001b_e.htm>. The average job tenure for those aged 15-24 is shorter, with an average of seventeen months in 1998, while the job tenure for those aged 25-44 is approximately seventy-seven months. See Mark MacKinnon, "Women gaining ground in work force: Better education is bringing more employment opportunities, longer job tenure, improving pay" *The Globe and Mail* (19 April 1999) (WL).

workers do not see their interests collectively represented either as shareholders in pension plans or as members of unions. Such workers are more likely to be women, single parents, immigrants, the disabled, visible minorities, and part-time workers with no benefit entitlements.[10] These are the workers who do not have the bargaining power to protect their rights.

Sarra observes that in 2001, over 2000 commercial proposals to restructure or compromise debt in order to avoid bankruptcy were filed by smaller corporations under the BIA. While Sarra suggests that reliable statistics are not available, one may estimate that the number of CCAA proposals is significantly lower.[11] The BIA process is highly rule driven and is overseen by a trustee in bankruptcy rather than the court, thus reducing the costs of negotiation and court appearances. For these reasons, Sarra suggests that the BIA proposal provisions do not pose the same kind of challenges as the CCAA in discerning the public interest in the workout process. Sarra suggests that because the court provides judicial oversight of the restructuring process under the CCAA, the issue of balancing the rights of creditors with the public interest arises.

While BIA proposals do not implicate the employment of thousands of workers in each instance, collectively the number of jobs and the human capital investment at risk with limited representation and decision rights beyond strict capital claims may approach the levels found under the CCAA. Further empirical work needs to be done to understand the nature of the interests implicated under the CCAA as compared to BIA commercial proposals and how a more codified system operates to balance these interests as compared to the more fluid CCAA. One regime cannot be studied in isolation of the other where the goal is to recognize a diverse range of stakeholder interests. Even within the CCAA, further work needs to be done to consider how the interests of unionized workers with pension plans are balanced with and against those without pension plans.

---

[10] In 1997, 91 per cent of Canadian men were entitled to receive CPP/QPP benefits and 51 per cent of Canadian men had a private pension. By comparison, 75 per cent of Canadian women were entitled to receive CPP/QPP benefits and 25 per cent of Canadian women had a private pension. See Chris Eby, "Income gap between the sexes closing: StatsCan" *National Post* (12 December 2000) at A4.

[11] According to Industry Canada, there were 1888 commercial proposals under the BIA in 2002 and, on average, approximately 20 CCAA cases per year for the previous three years. Presentation to the Senate Committee on Banking and Commerce on the statutory review of the BIA and the CCAA, 7 May 2003, online: <http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/vwGeneratedInterE/h_br01368e.html>.

B. *A Plea for Change?*

This book is not a plea for change. Sarra states that "enterprise wealth maximization as a substantive objective of insolvency law can be effected under current insolvency and corporations statutory language."[12] She suggests that the current role of the judiciary is to successfully facilitate the objectives of bankruptcy legislation by reconciling the interests of equity and credit. The existing regime and the role of the judiciary does not need to be overhauled to fit within Sarra's model. The only change required is that courts take into account non-traditional stakeholder investments and assets, assuring such stakeholders participatory rights in the process.

Based on the case studies that Sarra offers as examples, one is left with the question of whether participation rights will be meaningful if the hierarchy of traditional creditors' claims is preserved and judges are not provided with a set of guidelines to consistently balance the public interest with other interests. Although it is true that the symbolic politics of recognizing such interests is important, it is questionable whether the participation of a broader range of stakeholders will result in workers sharing in any surplus of a restructured corporation through changed governance structures, retained employment, or deferred wages. It may be the case that workers are granted recognition and participation rights, but the only parties to benefit are traditional creditors who can placate any community concerns by appearing to take into account the public interest and, at the same time, gain from the information that these workers can provide. Future work may empirically test the nature of the gains that social stakeholders reap from increased participation and decision rights in the CCAA process and how these increased rights are accorded along the lines of gender, race, class, and ability.

C. *Methodology*

In what is clearly a novel attempt at creating a conceptual model for the CCAA, the reader is left with the impression that the repeat participants in the CCAA who are referenced here may have overstated their public interest at different junctures. While Sarra does not set out to produce a piece of socio-legal scholarship she has clearly invested much time in interviewing numerous participants in CCAA proceedings. However, her analysis of the CCAA, while firmly situated in American theoretical work, does not probe beyond Canadian case law or anecdotal comments in papers

---

[12] *Creditor Rights and the Public Interest*, *supra* note 1 at 101.

produced by bankruptcy practitioners, with the result that the reader is unable to see beyond the distorted picture that emerges after a CCAA restructuring is completed.

Creditor Rights and the Public Interest may be built upon by future qualitative empirical work that explores the social and legal issues implicated in a CCAA reorganization by way of transcribed interviews conducted with judges, a diverse range of workers, tort claimants, governments, community groups, environmental groups, women's groups, and bankruptcy practitioners. It may be that the stakeholders to whose interests Sarra seeks to give meaning are not interested in focusing their efforts on such a process. For example, participants in Air Canada's CCAA proceedings have made it clear that from their perspective, the best outcome to protect the interests of all employees would have been through a consensual process outside of a CCAA filing.[13]

III. CONCLUSION

Applying Sarra's enterprise value maximization model to the Air Canada proceedings produces mixed results. It appears that the Air Canada restructuring, up to the point of writing, has accorded significant participation and decision rights to unions. The result of such rights was a restriction of the power contained in the initial CCAA order that permitted Air Canada to rewrite labor contracts pending negotiations between the parties.[14] Justice Winkler was appointed to facilitate this out-of-court negotiation.[15] However, there continues to be a lack of informational symmetry. The American-based restructuring experts hired by one of the unions recently commented on their surprise at how little information was available.[16] Further, in order to fund such restructuring efforts, the unions are raising dues and have had to let go some of the restructuring staff they hired.[17] The government has not become involved as a significant stakeholder or by way of financial contributions. Finally, no major changes

---

[13] "Air Canada sets the record straight with respect to pension plans" *Canada NewsWire* (3 April 2003).

[14] See Paul Vieira, "Airline unions chalk up legal victory: Air Canada's ability to torpedo collective bargaining agreements revoked by judge" *National Post* (23 April 2003) (WL). See also "Canadian auto workers files court challenge to Air Canada" *Canada NewsWire* (16 April 2003).

[15] Susan Pigg, "How a judge's plain speaking saved Air Canada; Justice Winkler man on mission 'Brought reason' to the negotiations" *The Toronto Star* (2 June 2003) (WL).

[16] Rick Westhead, "Bankruptcy-court judge scolds Air Canada and unions over slow negotiations" *Canadian Press* (16 May 2003) (WL).

[17] *Ibid.*

appear to have been made to corporate governance practices or to the composition of the Air Canada board.[18]

Together, the ongoing front-page newspaper material offered by Air Canada's restructuring and Sarra's contribution to the dearth of academic inquiry into the CCAA process provide a springboard for a lively debate on the future shape of Canada's bankruptcy regime. Sarra's book has opened up a space for insolvency outsiders to begin thinking about bankruptcy policy-making and reform. The conceptual model that Sarra thoughtfully develops throughout this book provides the groundwork for qualitative empirical work that further tests the implications of her conceptual model. Sarra is to be congratulated for a groundbreaking contribution to what will hopefully become a sustained area of academic inquiry in Canada.