NO. S1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,*
R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT,*
S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT
OF NEW WALTER ENERGY CANADA HOLDINGS, INC.,
NEW WALTER CANADIAN COAL CORP., NEW BRULE COAL CORP.,
NEW WILLOW CREEK COAL CORP., NEW WOLVERINE COAL CORP.
AND CAMBRIAN ENERGYBUILD HOLDINGS ULC

PETITIONERS

BOOK OF AUTHORITIES OF THE UNITED MINE WORKERS OF AMERICA 1974 PENSION PLAN AND TRUST (VOLUME 3)

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TAB 68

127 S.Ct. 2310
Supreme Court of the United States

Jeffrey BECK, liquidating trustee of the Estates of Crown Vantage, Inc. and Crown Paper Company, Petitioner,
v.
PACE INTERNATIONAL UNION et al.

No. 05–1448.
|
Argued April 24, 2007.
|
Decided June 11, 2007.

Synopsis
Background: After Chapter 11 debtors, in the course of liquidation proceedings, decided to terminate their pension plans through purchase of annuity rather than by merging plans into multiemployer plan sponsored by union, plan participants and union filed adversary complaint, asserting that debtors breached their fiduciary duties under the Employee Retirement Income Security Act (ERISA) by failing to adequately consider the proposed merger. The United States Bankruptcy Court for the Northern District of California found breach of fiduciary duty and ordered distribution of $5 million in residual assets for benefit of plan participants and beneficiaries. The United States District Court for the Northern District of California, Marilyn H. Patel, Chief Judge, 2003 WL 745114, dismissed union for lack of standing, but affirmed the preliminary injunction. The United States Court of Appeals for the Ninth Circuit, 427 F.3d 668, affirmed as to issue of fiduciary duty. Petition for certiorari was granted.

[Holding:] The Supreme Court, Justice Scalia, held that merger with a multiemployer benefit plan was not a permissible method of terminating a single-employer defined-benefit pension plan.

Reversed and remanded.

****2312 *96** *Syllabus* [*]

Respondent PACE International Union represented employees covered by single-employer defined-benefit pension plans sponsored and administered by Crown, which had filed for bankruptcy. Crown rejected the union's proposal to terminate the plans by merging them with the union's own multiemployer plan, opting instead for a standard termination through the purchase of annuities, which would allow Crown to retain a $5 million reversion after satisfying its obligations to plan participants and beneficiaries. The union and respondent plan participants (hereinafter, collectively, PACE) filed an adversary action in the Bankruptcy Court, alleging that Crown's directors had breached their fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.,* by neglecting to give diligent consideration to PACE's merger proposal. The court ruled for PACE, and petitioner bankruptcy trustee appealed to the District Court, which affirmed in relevant part, as did the Ninth Circuit. The Ninth Circuit acknowledged that the decision to terminate a pension plan is a business decision not subject to ERISA's fiduciary obligations, but reasoned that the implementation of a termination decision is fiduciary in nature. It then determined that merger was a permissible termination method and that Crown therefore had a fiduciary obligation to consider PACE's merger proposal seriously, which it had failed to do.

Held: Crown did not breach its fiduciary obligations in failing to consider PACE's merger proposal because merger is not a permissible form of plan termination under ERISA. Section 1341(b)(3)(A) provides: "In ... any final ****2313** distribution of assets pursuant to ... standard termination ..., the plan administrator shall ... (i) purchase irrevocable commitments from an insurer to provide all benefit liabilities under the plan, or ... (ii) in accordance with the provisions of the plan and any applicable regulations, otherwise fully provide all benefit liabilities under the plan." The parties agree that clause (i) refers to the purchase of annuities, and that clause (ii) allows for lump-sum distributions. These are by far the most common distribution methods. To decide that merger ***97** is also a permissible method, the Court would have to disagree with the Pension Benefit Guaranty Corporation (PBGC), the entity administering the federal insurance program that protects plan benefits, which takes the position that § 1341(b)(3)(A) does *not* permit merger as a method of termination because merger is an *alternative* to (rather than an example of) plan termination. The Court has traditionally deferred to the PBGC when interpreting ERISA. Here, the Court believes that the PBGC's policy is based upon a construction of the statute that is permissible, and indeed the more plausible.

PACE argues that § 1341(b)(3)(A)(ii)'s residual provision referring to an asset distribution that "*otherwise* fully provide[s] all benefit liabilities under the plan" covers merger because annuities (covered by § 1341(b)(3)(A)(i)) are an example of a permissible means of "provid[ing] ... benefit liabilities," and merger is the legal equivalent of annuitization. Even assuming that PACE is right about the meaning of the word "otherwise," the clarity necessary to disregard the PBGC's considered views is lacking for three reasons. First, terminating a plan through purchase of annuities formally severs ERISA's applicability to plan assets and employer obligations, whereas merging the Crown plans into PACE's multiemployer plan would result in the former plans' assets remaining *within* ERISA's purview, where they could be used to satisfy the benefit liabilities of the multiemployer plan's other participants and beneficiaries. Second, although ERISA expressly allows the employer to (under certain circumstances) recoup surplus funds in a standard termination, § 1344(d)(1), (3), as Crown sought to do here, merger would preclude the receipt of such funds by reason of § 1103(c), which prohibits employers from misappropriating plan assets for their own benefit. Third, merger is nowhere mentioned in § 1341, but is instead dealt with in an entirely different set of statutory sections setting forth entirely different rules and procedures, §§ 1058, 1411, and 1412. PACE's argument that the procedural differences could be reconciled by requiring a plan sponsor intending to use merger as a termination method to follow the rules for both merger and termination is condemned by the confusion it would engender and by the fact that it has no apparent basis in ERISA. Even from a policy standpoint, the PBGC's construction of the statute is eminently reasonable because termination by merger could have detrimental consequences for the participants and beneficiaries of a single-employer plan, as well as for plan sponsors. Pp. 2315 – 2321.

427 F.3d 668, reversed and remanded.

SCALIA, J., delivered the opinion for a unanimous Court.

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Opinion

Justice SCALIA delivered the opinion of the Court.

***98** We decide in this case whether an employer that sponsors and administers a single-employer defined-benefit pension plan has a fiduciary obligation under the Employee Retirement Income Security Act of 1974 (ERISA), 88 Stat. 829, as amended, 29 U.S.C. § 1001 *et seq.,* to consider a merger with a multiemployer plan as a method of terminating the plan.

I

[1] Crown Paper and its parent entity, Crown Vantage (the two hereinafter referred to in the singular as Crown), employed 2,600 persons in seven paper mills. PACE International Union, a respondent here, represented employees covered by 17 of Crown's defined-benefit pension plans. A defined-benefit plan, "as its name implies, is one where the employee, upon retirement, is entitled to a fixed periodic payment." *Commissioner v. Keystone Consol. Industries, Inc.,* 508 U.S. 152, 154, 113 S.Ct. 2006, 124 L.Ed.2d 71 (1993). In such a plan, the employer generally shoulders the investment risk. It is the employer who must make up for any deficits, but also the employer ***99** who enjoys the fruits (whether in the form of lower plan contributions or sometimes a reversion of assets) if plan investments perform beyond expectations. See *Hughes Aircraft Co. v. Jacobson,* 525 U.S. 432, 439–440, 119 S.Ct. 755, 142 L.Ed.2d 881 (1999). In this case, Crown served as both plan sponsor and plan administrator.

[2] In March 2000, Crown filed for bankruptcy and proceeded to liquidate its assets. ERISA allows employers to terminate their pension plans voluntarily, see *Pension Benefit Guaranty Corporation v. LTV Corp.,* 496 U.S. 633, 638, 110 S.Ct. 2668, 110 L.Ed.2d 579 (1990), and in the summer of 2001, Crown began to consider a "standard termination," a condition of which is that the terminated plans have sufficient assets to cover benefit liabilities. § 1341(b)(1)(D); *id.,* at 638–639, 110 S.Ct. 2668. Crown focused in particular on the possibility of a standard termination through purchase of annuities, one statutorily specified method of plan termination. See § 1341(b)(3)(A)(i). PACE, however, had ideas of its own. It interjected itself into Crown's termination discussions and proposed that, rather than buy annuities, Crown instead merge the plans covering PACE union members with the PACE Industrial Union Management Pension Fund (PIUMPF), a multiemployer or "Taft–Hartley" plan. See § 1002(37). Under the terms of the PACE-proposed agreement, Crown would be required to convey all plan assets to PIUMPF; PIUMPF would assume all plan liabilities.

Crown took PACE's merger offer under advisement. As it reviewed annuitization bids, however, it discovered that it had overfunded certain of its pension plans, so ****2315** that purchasing annuities would allow it to retain a projected $5 million reversion for its creditors after satisfying its obligations to plan participants and beneficiaries. See § 1344(d)(1) (providing for reversion upon plan termination where certain conditions are met). Under PACE's merger proposal, by contrast, the $5 million would go to PIUMPF. What is more, the Pension Benefit Guaranty Corporation (PBGC), which ***100** administers an insurance program to protect plan benefits, agreed to withdraw the proofs of claim it had filed against Crown in the bankruptcy proceedings if Crown went ahead with an annuity purchase. Crown had evidently heard enough. It consolidated 12 of its pension plans [1] into a single plan, and terminated that plan through the purchase of an $84 million annuity. That annuity fully satisfied Crown's obligations to plan participants and beneficiaries and allowed Crown to reap the $5 million reversion in surplus funds.

PACE and two plan participants, also respondents here (we will refer to all respondents collectively as PACE), thereafter filed an adversary action against Crown in the Bankruptcy Court, alleging that Crown's directors had breached their fiduciary duties under ERISA by neglecting to give diligent consideration to PACE's merger proposal. The Bankruptcy Court sided with PACE. It found that the decision whether to purchase annuities or merge with PIUMPF was a fiduciary decision, and that Crown had breached its fiduciary obligations by giving insufficient study to the PIUMPF proposal. Rather than ordering Crown to cancel its annuity (which would have resulted in a substantial penalty payable to Crown's annuity provider), the Bankruptcy Court instead issued a preliminary injunction preventing Crown from obtaining the $5 million reversion. It subsequently approved a distribution of that reversion for the benefit of plan participants and beneficiaries, which distribution was stayed pending appeal. [2]

***101** Petitioner, the trustee of the Crown bankruptcy estates, appealed the Bankruptcy–Court decision to the District Court, which affirmed in relevant part, as did the Court of Appeals for the Ninth Circuit. The Ninth Circuit acknowledged that "the decision to terminate a pension plan is a business decision not subject to ERISA's fiduciary obligations," but reasoned that "the *implementation* of a decision to terminate" is fiduciary in nature. 427 F.3d 668, 673 (2005). It then determined that merger was a permissible means of plan termination and that Crown therefore had a fiduciary obligation to consider PACE's merger proposal seriously, which it had failed to do. Petitioner thereafter sought rehearing in the Court of Appeals, this time with the support of the PBGC and the Department of Labor, who agreed with petitioner that the Ninth Circuit's judgment was in error. The Ninth Circuit held to its original decision, and we granted certiorari. 549 U.S. 1177, 127 S.Ct. 1144, 166 L.Ed.2d 909 (2007).

****2316** II

[3] Crown's operation of its defined-benefit pension plans placed it in dual roles as plan sponsor and plan administrator; an employer's fiduciary duties under ERISA are implicated only when it acts in the latter capacity. Which hat the employer is proverbially wearing depends upon the nature of the function performed, see *Hughes Aircraft Co., supra,* at 444, and is an inquiry that is aided by the common law of trusts which serves as ERISA's backdrop, see *Pegram v. Herdrich,* 530 U.S. 211, 224, 120 S.Ct. 2143, 147 L.Ed.2d 164 (2000); *Lockheed Corp. v. Spink,* 517 U.S. 882, 890, 116 S.Ct. 1783, 135 L.Ed.2d 153 (1996).

[4] **[5]** It is well established in this Court's cases that an employer's decision *whether* to terminate an ERISA plan is a settlor function immune from ERISA's fiduciary obligations. See, *e.g., ibid.*; *Curtiss–Wright Corp. v. Schoonejongen,* 514 U.S. 73, 78, 115 S.Ct. 1223, 131 L.Ed.2d 94 (1995). And because "decision[s] regarding the form ***102** or structure" of a plan are generally settlor functions, *Hughes Aircraft Co.,* 525 U.S., at 444, 119 S.Ct. 755, PACE acknowledges that the decision to merge plans is "normally [a] plan sponsor decisio[n]" as well. Brief for Respondents 13–14, n. 5, 20–21; see also *Malia v. General Electric Co.,* 23 F.3d 828, 833 (C.A.3 1994) (holding that employer's decision to merge plans "d[id] not invoke the fiduciary duty provisions of ERISA"). But PACE says that its proposed merger was different, because the PIUMPF merger represented a *method of terminating* the Crown plans. And just as ERISA imposed on Crown a fiduciary obligation in its selection of an appropriate annuity provider when terminating through annuities, see 29 CFR §§ 2509.95–1, 4041.28(c)(3) (2006), so too, PACE argues, did it require Crown to consider merger.

The idea that the decision whether to merge could switch from a settlor to a fiduciary function depending upon the context in which the merger proposal is raised is an odd one. But once it is realized that a merger is simply a transfer of assets and liabilities, PACE's argument becomes somewhat more plausible: The purchase of an annuity is akin to a transfer of assets and liabilities (to an insurance company), and if Crown was subject to fiduciary duties in selecting an annuity provider, why could it automatically disregard PIUMPF simply because PIUMPF happened to be a multiemployer plan rather than an insurer? There is, however, an antecedent question. In order to affirm the judgment below, we would have to conclude (as the Ninth Circuit did) that merger is, in the first place, a *permissible* form of plan termination under ERISA. That requires us to delve into the statute's provisions for plan termination.

[6] ERISA sets forth the exclusive procedures for the standard termination of single-employer pension plans. § 1341(a)(1); *Hughes Aircraft Co., supra,* at 446. Those procedures are exhaustive, setting detailed rules for, *inter alia,* notice by the plan to affected parties, § 1341(a)(2), review by the PBGC, § 1341(b)(2)(A), (C), and final distribution of plan ***103** funds, § 1341(b)(2)(D), § 1344. See generally E. Veal & E. Mackiewicz, Pension Plan Terminations 43–61 (2d ed.1998) (hereinafter Veal & Mackiewicz). At issue in this case is § 1341(b)(3)(A), the provision of ERISA setting forth the permissible *methods* of terminating a single-employer plan and distributing plan assets to participants and beneficiaries. Section 1341(b)(3)(A) provides as follows:

> "In connection with any final distribution of assets pursuant to the standard termination of the plan under this subsection, the plan administrator shall distribute ****2317** the assets in accordance with section 1344 of this title. In distributing such assets, the plan administrator shall—
>
> "(i) purchase irrevocable commitments from an insurer to provide all benefit liabilities under the plan, or
>
> "(ii) in accordance with the provisions of the plan and any applicable regulations, otherwise fully provide all benefit liabilities under the plan...."

The PBGC's regulations impose in substance the same requirements. See 29 CFR § 4041.28(c)(1). Title 29 U.S.C. § 1344, which is referred to in § 1341(b)(3)(A), sets forth a specific order of priority for asset distribution, including (under certain circumstances) reversions of excess funds to the plan sponsor, see § 1344(d)(1).

[7] The parties to this case all agree that § 1341(b)(3)(A)(i) refers to the purchase of annuities, see 29 CFR § 4001.2 (defining "irrevocable commitment"), and that § 1341(b)(3)(A)(ii) allows for lump-sum distributions at present discounted value (including rollovers into individual retirement accounts). As PACE concedes, purchase of annuity contracts and lump-sum payments are "by far the most common distribution methods." Brief for Respondents 45; see also Veal & Mackiewicz 72–73 ("The basic alternatives are the purchase of annuity contracts or some form of lump-sum cashout"). To affirm the Ninth Circuit, we would have to decide that ***104** merger is a permissible method as well.[3] And we would have to do that over the objection of the PBGC, which (joined by the Department of Labor) disagrees with the Ninth Circuit, taking the position that § 1341(b)(3)(A) does *not* permit merger as a method of termination because (in its view) merger is an *alternative* to (rather than an example of) plan termination. See Brief for United States as *Amicus Curiae* 8, 17–30. We have traditionally deferred to the PBGC when interpreting ERISA, for "to attempt to answer these questions without the views of the agencies responsible for enforcing ERISA, would be to embar[k] upon a voyage without a compass." *Mead Corp. v. Tilley,* 490 U.S. 714, 722, 725–726, 109 S.Ct. 2156, 104 L.Ed.2d 796 (1989) (internal quotation marks omitted); see also *LTV Corp.,* 496 U.S., at 648, 651, 110 S.Ct. 2668. In reviewing the judgment below, we thus must examine "whether the PBGC's policy is based upon a permissible construction of the statute." *Id.,* at 648, 110 S.Ct. 2668.[4]

****2318** ***105** We believe it is. PACE has "failed to persuade us that the PBGC's views are unreasonable," *Mead Corp., supra,* at 725. At the outset, it must be acknowledged that the statute, with its general residual clause in § 1341(b)(3)(A)(ii), is potentially more embracing of alternative methods of plan termination (whatever they may be) than longstanding ERISA practice, which appears to have employed almost exclusively annuities and lump-sum payments. But we think that the statutory text need not be read to include mergers, and indeed that the PBGC offers the better reading in excluding them. Most obviously, Congress nowhere expressly provided for merger as a permissible means of termination. Merger is not mentioned in § 1341(b)(3)(A), much less in any of § 1341's many subsections. Indeed, merger is expressly provided for in an entirely separate set of statutory sections (of which more in a moment, see *infra,* at 2319 – 2321). PACE nevertheless maintains that merger is clearly covered under § 1341(b)(3)(A)(ii)'s residual clause, which refers to a distribution of assets that "otherwise fully provide[s] all benefit liabilities under the plan." By PACE's reasoning, annuities are covered under § 1341(b)(3)(A)(i); annuities are—by virtue of the word "otherwise"—an *example* of a means by which a plan may "fully provide all benefit liabilities under the plan," § 1341(b)(3)(A)(ii); and therefore, "at the least," any method of termination that is the "legal equivalent" of annuitization is permitted, Brief for Respondents 23. Merger, PACE argues, is such a legal equivalent.

We do not find the statute so clear. Even assuming that PACE is right about "otherwise"—that the word indicates ***106** that annuities are *one example* of satisfying the residual clause in § 1341(b)(3)(A)(ii)—we still do not find mergers covered with the clarity necessary to disregard the PBGC's considered views. Surely the phrase "otherwise fully provide all benefit liabilities under the plan" is not without some teeth. And we think it would be reasonable for the PBGC to determine both that merger is not like the purchase of annuities in its ability to "fully provide all benefit liabilities under the plan," and that the statute's distinct treatment of merger and termination provides clear evidence that one is not an example of the other. Three points strike us as especially persuasive in these regards.

[8] First, terminating a plan through purchase of annuities (like terminating through distribution of lump-sum payments) formally severs the applicability of ERISA to plan assets and employer obligations. Upon purchasing annuities, the employer is no longer subject to ERISA's multitudinous requirements, such as (to name just one) payment of insurance premiums to the PBGC, § 1307(a). And the PBGC is likewise no longer liable for the deficiency in the event that the plan becomes insolvent; there *are* no more benefits for it to guarantee. The assets of the plan are wholly removed from the ERISA system, and plan participants and beneficiaries must rely primarily (if not exclusively) on state contract remedies if they do not receive proper payments or are otherwise denied access to their funds. Further, from the standpoint of the participants and beneficiaries, the risk associated with an annuity relates solely to the ****2319** solvency of an insurance company, and not the performance of the merged plan's investments.

Merger is fundamentally different: It represents a *continuation* rather than a *cessation* of the ERISA regime. If Crown were to have merged its pension plans into PIUMPF, the plan assets would have been combined with the assets of the multiemployer plan, where they could then be used to satisfy the benefit liabilities of participants and beneficiaries ***107** *other than* those from the original Crown plans. Those assets would remain *within* ERISA's purview, the PBGC would maintain responsibility for them, and if Crown continued to employ the plan participants it too would remain subject to ERISA. Finally, plan participants and beneficiaries would have their recourse not through state contract law, but through the ERISA system, just as they had prior to merger.

[9] **[10]** Second, in a standard termination ERISA allows the employer to (under certain circumstances) recoup surplus funds, § 1344(d)(1), (3), as Crown sought to do here. But ERISA forbids employers to obtain a reversion *in the absence of a termination:* "A valid plan termination is a prerequisite to a reversion of surplus plan assets to an employer." App. to Brief in Opposition 15a (PBGC Opinion Letter 85–25 (Oct. 11, 1985)); see also Veal & Mackiewicz 164–165. Crown could not simply extract the $5 million surplus from its plans, nor could it have done so once those assets had transferred to PIUMPF. This would have run up against ERISA's anti-inurement provision, which prohibits employers from misappropriating plan assets for their own benefit. See § 1103(c). Consequently, we think the PBGC was entirely reasonable in declining to recognize as a form of termination a mechanism that would preclude the receipt of surplus funds, which is specifically authorized upon termination. [5]

***108** Third, the structure of ERISA amply (if not conclusively) supports the conclusion that § 1341(b)(3)(A)(ii) does not cover merger. As noted above, merger is nowhere mentioned in § 1341, and is instead dealt with in an entirely different set of statutory sections setting forth entirely different rules and procedures. Compare § 1058 (general merger provision), § 1411 (mergers between multiemployer plans), and § 1412 (mergers between multiemployer and single-employer plans) with § 1341 (termination of single-employer plans), § 1341a (termination of multiemployer plans); see generally Veal & Mackiewicz 31–40 (describing merger as an alternative to plan termination). Section 1058, the general merger provision, in fact quite clearly contemplates that merger and termination are not one and the same, forbidding merger "unless each participant in the plan would *(if the plan then terminated)* receive a benefit immediately after the merger ... which is equal to or greater than the benefit he would have been entitled to receive immediately before the ****2320** merger ... *(if the plan had then terminated)*." (Emphasis added.)

As for the different rules and procedures governing termination and merger: Most critically, plans seeking to terminate must provide advance notice to the PBGC, as well as extensive actuarial information. § 1341(b)(2)(A). The PBGC has the authority to halt the termination if it determines that plan assets are insufficient to cover plan liabilities. § 1341(b)(2)(C). Merger, by contrast, involves considerably less PBGC oversight, and the PBGC has no similar ability to cancel, see Brief for United States as *Amicus Curiae* 24. And the rules governing notice to the PBGC are either different or nonexistent. Section 1412, the provision governing merger between a single and multiemployer plan (the form of merger contemplated by PACE's proposal) makes no mention of early notice to the PBGC. And while mergers between multiemployer plans do require 120–days ***109** advance notice, § 1411(b)(1), this still differs from the general notice provision for termination of single-employer plans, which requires notice to the PBGC "[a]s soon as practicable" after notice is given to affected parties, § 1341(b)(2)(A). Relatedly, § 1341(a)(2) also requires that, in a standard termination, written notice to plan participants and beneficiaries include "any related additional information required in regulations of the [PBGC]." Those regulations require, among other things, that the plan inform participants and beneficiaries that upon distribution, "the PBGC no longer guarantees ... plan benefits." 29 CFR § 4041.23(b)(9). (This requirement of course has no relevance to a merger, because after a merger the PBGC *continues* to guarantee plan benefits.)

PACE believes that these procedural differences can be ironed over rather easily. It insists:

> "Many plan mergers take place without intent to terminate a plan; in those cases, the requirements for plan merger can be followed without consulting the requirements for plan termination. Conversely, many plan terminations take place without an associated merger; in those cases there is no need to consult the requirements for mergers. But if a plan sponsor intends to use merger as a method of implementing a plan termination, it simply must follow the rules for both merger and termination." Brief for Respondents 36.

PACE similarly explains that while the PBGC does not approve "ordinary merger [s]," PBGC approval would be necessary when a merger is designed to terminate a plan. *Id.,* at 37. The confusion invited by PACE's proposed framework is alone enough to condemn it. How could a plan be sure that it was in one box rather than the other? To avoid the risk of liability, should it simply follow both sets of rules all of the time? PACE's proposal is flawed for another reason ***110** as well: It has no apparent basis in the statute. The separate provisions governing termination and merger quite clearly treat the two as wholly different transactions, with no exception for the case where merger is used for termination.

For all of the foregoing reasons, we believe that the PBGC's construction of the statute is a permissible one, and indeed the more plausible. Crown did not breach its fiduciary obligations in failing to consider PACE's merger proposal because merger is not a permissible form of termination. Even from a policy standpoint, the PBGC's choice is an eminently reasonable one, since termination by merger could have detrimental consequences for plan beneficiaries and plan sponsors alike. When a single-employer plan is merged into a multiemployer plan, the original participants ****2321** and beneficiaries become dependent upon the financial well-being of the multiemployer plan and its contributing members. Assets of the single-employer plan (which in this case were capable of fully funding plan liabilities) may be used to satisfy commitments owed to *other* participants and beneficiaries of the (possibly underfunded) multiemployer plan. The PBGC believes that this arrangement creates added risk for participants and beneficiaries of the original plan, particularly in view of the lesser guarantees that the PBGC provides to multiemployer plans, compare § 1322 with § 1322a. See Brief for United States as *Amicus Curiae* 29, and n. 11. For employers, the ill effects are demonstrated by the facts of this very case: By diligently funding its pension plans, Crown became the bait for a union bent on obtaining a surplus that was rightfully Crown's. All this after Crown purchased an annuity that none dispute was sufficient to satisfy its commitments to plan participants and beneficiaries.

* * *

We hold that merger is not a permissible method of terminating a single-employer defined-benefit pension plan. The ***111** judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

All Citations

551 U.S. 96, 127 S.Ct. 2310, 168 L.Ed.2d 1, 75 USLW 4399, 48 Bankr.Ct.Dec. 100, 40 Employee Benefits Cas. 2281, 07 Cal. Daily Op. Serv. 6659, 2007 Daily Journal D.A.R. 8497, Pens. Plan Guide (CCH) P 24000B, 20 Fla. L. Weekly Fed. S 339

Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

[1] Crown's various other pension plans are not at issue in this case.

[2] PACE now suggests that it would have been willing to agree to a merger in which Crown kept its surplus funds. Brief for Respondents 17, n. 7. But this is belied not only by the terms of the proposed merger agreement, but by the fact that PACE actively sought and obtained a preliminary injunction freezing Crown's $5 million reversion. The Bankruptcy Court having rejected PACE's request to undo the annuity contract, PACE has provided no reason for pursuing this litigation other than to obtain the $5 million that remained after Crown satisfied its benefit commitments. Moreover, as PACE concedes, whether the parties would have agreed to a merger arrangement that did not include the $5 million is "speculation." Tr. of Oral Arg. 42.

[3] We would not have to decide that question of statutory interpretation if Crown's pension plans disallowed merger. Any method of termination permitted by § 1341(b)(3)(A)(ii) must also be one that is "in accordance with the provisions of the plan." Crown thus could have drafted its plan documents to limit the available methods of termination, so that merger was not permitted. Petitioner argued below that Crown had done just that. Though the District Court concluded that the plan terms allowed for merger, App. to Pet. for Cert. 47, the Ninth Circuit declined to consider the plan language because it held that petitioner had failed to preserve the argument in the Bankruptcy Court. Petitioner did not seek certiorari on the factbound issues of waiver and plan interpretation, and we accordingly do not address them here.

[4] PACE argues that the PBGC took an inconsistent approach in several opinion letters from the 1980's concerning the applicability of certain joint guidelines for asset reversions during complex termination transactions. See App. to Brief in Opposition 6a–9a (Opinion Letter 85–11 (May 14, 1985)); *id.,* at 10a–13a (Opinion Letter 85–21 (Aug. 26, 1985)); *id.,* at 14a–16a (Opinion Letter 85–25 (Oct. 11, 1985)). But insofar as the PBGC's consistency is even relevant to whether we should accord deference to its presently held views, none of those letters so much as hints that the PBGC treated merger as a permissible form of plan termination. In fact, to the extent they even speak to the question, they clearly show the opposite. In Opinion Letter 85–25, for example, the PBGC explained that the joint guidelines for asset reversions did not apply to "a transfer [of assets and liabilities] from a single-employer plan to an ongoing multiemployer plan *followed by* the termination of the single-employer plan." *Id.*, at 15a (emphasis added). By characterizing the proposed transaction as one that took place in two separate steps (merger *and then* termination), this letter fully contemplated that merger was *not* an *example of* plan termination.

[5] This inability to recover surplus funds through a merger could not be remedied, as PACE now suggests, by structuring the transaction so that Crown provided to PIUMPF only assets sufficient to cover plan liabilities (effectively creating a spinoff from Crown's plans and merging that spinoff plan with PIUMPF). Under that arrangement, Crown could indeed obtain the $5 million reversion—not, however, by reason of the merger-called-termination, but only by subsequent termination of the *residual* plan. See, *e.g., id.*, at 14a–16a (PBGC Opinion Letter 85–25 (Oct. 11, 1985)) (describing such a sequence of transactions). This falls short of rendering the *merger* a termination permitting recovery of surplus funds. That a transfer of assets can occur in anticipation of a future termination does not render that transfer itself a termination.

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TAB 69

522 F.3d 948
United States Court of Appeals,
Ninth Circuit.

Slobodanka BLAZEVSKA, surviving spouse and personal representative of the Estate of Risto Blazevski, deceased; Eleonora Blazevska, surviving child of Risto Blazevski, deceased; Dimitar Blazevski, surviving child of Risto Blazevski, deceased; Dragan Boskovik, as surviving spouse and personal representative of the Estate of Dimka Ilkovka–Boskovik, deceased, and as guardian of their minor child Ana Boskovik; Veselin Boskovik, surviving child of Dimka Ilkovka–Boskovik, deceased; Biljana Bozinovska, as surviving spouse and personal representative of the Estate of Ace Bozinovski, deceased and as guardian of their two minor children, Stefan and Andrej Bozinovski; Vesena Ivanoska, as surviving spouse and personal representative of the Estate of Branko Ivanovski, deceased and as guardian of their two minor children, Marta Ivanovska and Andrej Ivanovski; Mirjana Glavcic–Krestevska, as surviving spouse and personal representative of the Estate of Mile Krestevski, deceased; Vladimir Krestevski, surviving child of Mile Krestevski, deceased; Violeta Markovska, as surviving spouse and personal representative of the Estate of Marko Markovski, deceased; Zoran Markovski; Goran Markovski, surviving children of Marko Markovski, deceased; Vilma Trajkovska, as surviving spouse and personal representative of the Estate of Boris Trajkovski, deceased, and as guardian of their two minor children, Sara Trajkovska and Stefan Trajkovski; Zlatka Velinova, as surviving spouse and personal representative of the Estate of Boris Velinov, deceased; Jovance Velinov; Olga Velinova, surviving parent of Boris Velinov, deceased, Plaintiffs–Appellants,
v.
RAYTHEON AIRCRAFT COMPANY, a Kansas Corporation, Defendant–Appellee.

No. 06–16028.
|
Argued and Submitted Feb. 14, 2008.
|
Filed April 10, 2008.

Synopsis
Background: Macedonian survivors of passengers killed in airplane crash in Bosnia brought wrongful death action against airplane manufacturer. The United States District Court for the Northern District of California, Phyllis J. Hamilton, J., 2006 WL 1310455, entered summary judgment for manufacturer. Survivors appealed.

[Holding:] The Court of Appeals, D.W. Nelson, Senior Circuit Judge, held that presumption against extraterritoriality did not preclude application of 18-year statute of repose of General Aviation Revitalization Act (GARA) to action.

Affirmed.

Attorneys and Law Firms

***950** Robert J. Nelson, Lieff, Cabraser, Heimann & Bernstein, LLP, San Francisco, CA, for the appellants.

Kirk C. Jenkins, Sedgwick, Detert, Moran & Arnold LLP, Chicago, IL, for the appellee.

Appeal from the United States District Court for the Northern District of California; Phyllis J. Hamilton, District Judge, Presiding. D.C. No. CV–05–04191–PJH.

Before: D.W. NELSON and HAWKINS, Circuit Judges, and ROBERT J. TIMLIN, * Senior Judge.

Opinion

D.W. NELSON, Senior Circuit Judge:

Slobodanka Blazevska and her co-appellants are the family members of eight Macedonian residents who died in a plane accident in Bosnia on February 26, 2004. The decedents, including the Macedonian president, were killed when their Beechcraft Super King Air 200 crashed into a hilltop. The plaintiffs brought a wrongful death action against Raytheon, the manufacturer of the plane. The district court granted summary judgment for the defendants, holding that plaintiffs' action was barred by the eighteen-year statute of repose in the General Aviation Revitalization Act of 1994 ("GARA"). Pub.L. No. 103 298, 108 Stat. 1552(codified at 49 U.S.C. § 40101 notes). The plaintiffs appealed, arguing that the presumption against extraterritoriality precludes GARA's application in this case. We affirm the order of the district court granting summary judgment for appellee Raytheon. The presumption against extraterritoriality is not implicated in this case, so GARA bars appellants' suit.

FACTUAL AND PROCEDURAL BACKGROUND

In early 1980, appellee Raytheon Aircraft Company ("Raytheon") manufactured a Beech Super King Air 200 Aircraft in Wichita, Kansas. Around April 4, 1980, Raytheon sold the aircraft to "The Beechcraft Organization for Central Europe." Later that month, the aircraft was delivered to the Republic of Macedonia, which retained ownership of the plane until its eventual destruction.

On February 26, 2004, the aircraft departed Skopje, Macedonia, bound for Mostar, Bosnia, with the President of Macedonia and his senior advisors aboard. In a thicket of rain and fog, the plane struck a tree while attempting to land. The accident killed all nine passengers, including the two co-pilots. The Aircraft Accident Report, prepared by the Bosnia and Herzegovina Directorate of Civil Aviation, ultimately attributed the crash to pilot error.

On October 17, 2005, appellants filed a wrongful death action against Raytheon. The complaint alleged three causes of action, all under Macedonian law, claiming the aircraft was defective and not crashworthy. On November 10, 2005, Raytheon filed its answer, denying the allegations and raising a number of affirmative defenses. Raytheon contended that the action was barred by GARA's eighteen-year statute of repose. The parties agreed to proceed with limited discovery until the district court resolved the issue of whether GARA applied. On February 15, 2006, Raytheon filed a motion for summary judgment, again asserting that GARA required a finding in its favor. On May 12, 2006, the district court issued an order granting Raytheon's motion for summary judgment, holding that GARA precluded ***951** the plaintiffs' claims. On that same day, the court entered judgment in favor of Raytheon on all claims.

JURISDICTION

Federal diversity jurisdiction is proper under 28 U.S.C. § 1332(a)(2). Appellants are all Macedonian citizens, appellee is a Kansas corporation, and the amount in controversy exceeds seventy-five thousand dollars. This court has jurisdiction to review the final judgment of a district court under 28 U.S.C. § 1291.

STANDARD OF REVIEW

[1] We review de novo a district court's grant of summary judgment that was based upon uncontested facts and a disputed construction of a federal statute. *Boyd v. United States,* 762 F.2d 1369, 1371 (9th Cir.1985). We must determine whether the district court correctly applied the relevant substantive law. *Lively v. Wild Oats Markets, Inc.,* 456 F.3d 933, 938 (9th Cir.2006) ("We also review *de novo* a district court's interpretation and construction of a federal statute."); *Olsen v. Idaho State Bd. of Med.,* 363 F.3d 916, 922(9th Cir.2004).

DISCUSSION

I. *Legal Standard—GARA*

[2] GARA is a statute of repose that limits aircraft manufacturers' liability to eighteen years after an aircraft is delivered. GARA §§ 2(a), 3(3). In 1994, Congress enacted this measure to limit the "long tail of liability" imposed upon the manufacturers of general aviation aircraft. *Lyon v. Agusta S.P.A.,* 252 F.3d 1078, 1084 (9th Cir.2001) (citing H.R.Rep. No. 103–525, pt. I, at 1–4 (1994), as *reprinted in* 1994 U.S.C.C.A.N. 1638, 1638–41). Congress was "deeply concerned about the enormous product liability costs" suffered by manufacturers. *Id.* The pertinent sections of GARA provide:

> Section 2. Time limitations on civil actions against aircraft manufacturers.
>
> (a) In general.—Except as provided in subsection (b), no civil action for damages for death or injury to persons or damage to property arising out of an accident involving a general aviation aircraft may be brought against the manufacturer of the aircraft or the manufacturer of any new component, system, subassembly, or other part of the aircraft, in its capacity as a manufacturer if the accident occurred—
>
> (1) after the applicable limitation period beginning on—
>
> (A) the date of delivery of the aircraft to its first purchaser or lessee, if delivered directly from the manufacturer; or
>
> (B) the date of first delivery of the aircraft to a person engaged in the business of selling or leasing such aircraft....
>
> Section 3. Other definitions.
>
> For the purposes of this Act—
>
> ....
>
> (3) the term "limitation period" means 18 years with respect to general aviation aircraft and the components, systems, subassemblies, and other parts of such aircraft....

GARA §§ 2(a), (3)(3).

[3] **[4]** The statute bars suits stemming from accidents that occurred more than eighteen years after the initial transfer of an aircraft. *Lyon,* 252 F.3d at 1084("If [the accident] occurs on the day after the GARA period runs, no action whatsoever is possible."). The statute acts not just as an affirmative defense, but instead "creates an explicit statutory right not to stand trial." *Estate of Kennedy v. Bell Helicopter Textron, Inc.,* 283 F.3d 1107, 1110 (9th Cir.2002).

***952** The accident at issue here occurred in 2004, more than eighteen years after appellee delivered the plane to the Macedonian government in 1980. Accordingly, Raytheon argues that GARA bars appellants' claims. Appellants counter that, in accord with the presumption against extraterritoriality, GARA's time bar should not apply under the circumstances of this case.

II. *The Presumption Against Extraterritoriality*

"The Supreme Court and this court have adhered to the longstanding principle of American law that legislation is presumed to apply only within the territorial jurisdiction of the United States unless the contrary affirmative intention of Congress is clearly expressed." *ARC Ecology v. U.S. Dep't of the Air Force,* 411 F.3d 1092, 1097 (9th Cir.2005) (citing *EEOC v. Arabian American Oil Co.,* 499 U.S. 244, 248, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991) (hereinafter "*Aramco* ")); *see also* *Smith v. United States,* 507 U.S. 197, 203–04, 113 S.Ct. 1178, 122 L.Ed.2d 548 (1993) (holding that the presumption applied to preclude application of the Federal Tort Claims Act's ("FTCA") waiver of sovereign immunity for a claim arising in Antarctica).

[5] **[6]** Under this presumption, a law passed by Congress is generally assumed to apply only to regulate conduct occurring within the boundaries of the United States. *See* *Pakootas v. Teck Cominco Metals, Ltd.,* 452 F.3d 1066, 1077–79(9th Cir.2006); *Envtl. Def. Fund, Inc. v. Massey,* 986 F.2d 528, 530–31 (D.C.Cir.1993). The presumption "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord." *Aramco,* 499 U.S. at 248, 111 S.Ct. 1227 (internal quotation marks omitted). In order to overcome the presumption, a party must show a clear expression of congressional intent to apply a statute beyond American soil. *Id.* at 258, 111 S.Ct. 1227.

In *Aramco,* the centerpiece of the Supreme Court's recent jurisprudence on the presumption, the Court held that Title VII of the Civil Rights Act of 1964 did not apply to a United States citizen working for an American company in a foreign country. *Id.* at 249, 111 S.Ct. 1227. Despite administrative interpretations to the contrary, the Court held that it must assume that Congress legislates under the presumption that a statute "is primarily concerned with domestic conditions." *Id.* at 248, 111 S.Ct. 1227. The Court further held that the presumption was not overcome because Congress did not make a "clear statement" suggesting that Title VII should apply to conduct occurring in a foreign country. *Id.* at 258, 111 S.Ct. 1227.

III. *Presumption Against Extraterritoriality Does Not Apply To GARA*

[7] Simply because a case's factual background involves some conduct occurring abroad does not mean that every statute governing the matter is subject to the presumption against extraterritoriality; a court must first inquire into whether applying a statute implicates any issue of extraterritoriality. *Massey,* 986 F.2d at 531–32. This requires considering the conduct the statute seeks to regulate. *See* *id.*; *see also* *Pakootas,* 452 F.3d at 1077("The difference between a domestic application of United States law and a presumptively impermissible extraterritorial application of United States law becomes apparent when we consider the conduct that the law prohibits."). Appellants contend that the conduct at issue in this case is a tort injury suffered in Macedonia. Under their logic, the place where the tort claim arises determines whether the various federal statutes governing a case are ***953** being applied extraterritorially. Appellants' reasoning oversimplifies the analysis.

In *Massey,* an environmental group brought a suit under the National Environmental Policy Act ("NEPA"), attempting to enjoin a federal agency from permitting the incineration of food waste in Antarctica. 986 F.2d at 529. Writing for the D.C. Circuit, Chief Judge Mikva stated:

> [T]he presumption against extraterritoriality is not applicable when the conduct regulated by the government occurs within the United States. By definition, an extraterritorial application of a statute involves the regulation of conduct beyond U.S. borders. Even where the significant effects of the regulated conduct are felt outside U.S. borders, the statute itself does not present a problem of extraterritoriality, so long as the conduct which Congress seeks to regulate occurs largely within the United States.

Id. at 531 (citing RESTATEMENT (SECOND) OF FOREIGN RELATIONS § 38 (1965)). The court concluded that "NEPA is designed to control the decisionmaking process of U.S. federal agencies, not the substance of agency decisions." *Id.* at 532. As a result, NEPA regulates domestic conduct because the federal agency's decisionmaking process occurs within the United States. *Id.* at 533. As summarized by Chief Judge Mikva, "since NEPA is designed to regulate conduct occurring within the territory of the United States, and imposes no substantive requirements which could be interpreted to govern conduct abroad, the presumption against extraterritoriality does not apply to this case." *Id.*

[8] Here, appellants have failed to show that an application of GARA would impermissibly regulate conduct that has occurred abroad. GARA only regulates the ability of a party to seek compensation from general aviation airplane manufacturers in American courts. *See* GARA § 2(a). It is not a statute governing the substantive standards involved in tort claims. GARA merely eliminates the power of any party to bring a suit for damages against a general aviation aircraft manufacturer, in a U.S. federal or state court, after the limitation period. The only conduct it could arguably be said to regulate is the ability of a party to initiate an action for damages against a manufacturer in American courts—an entirely domestic endeavor. Congress has no power to tell courts of foreign countries whether they could entertain a suit against an American defendant. It would be up to any foreign court to determine whether it wanted to apply GARA to litigation occurring within its borders. Accordingly, the presumption against extraterritoriality simply is not implicated by GARA's application.

Appellants attempt to differentiate *Massey* from the present case because the former was not a tort action. Appellants argue that *Massey* is distinguishable because it depended upon the conclusion that NEPA is a procedural regulation of a federal agency rather than a substantive rule of law. This is misleading. *Massey* did recognize that "NEPA is designed to control the decisionmaking process of U.S. federal agencies, not the substance of agency decisions." *Massey,* 986 F.2d at 532. But that recognition was not intended to suggest that there is something meaningful in the distinction between procedural and substantive laws. Rather, what was determinative for the D.C. Circuit was the locus of the conduct regulated by the statute—in that case, the agency's decisionmaking. *See id.* at 533. As the court noted, "[b]ecause the decisionmaking processes of federal agencies take place almost exclusively in this country and involve the workings of the United States government, they are uniquely domestic." *Id.* at 532. As reasoned by *Massey,* when deciding whether a statute implicates the presumption against extraterritoriality, ***954** courts must determine whether application of that statute would govern conduct occurring abroad. *Id.* at 533. Appellants have failed to show that GARA regulates any non-domestic conduct, because GARA only determines the scope of a manufacturer's liability in American courts.

Appellee's position finds further support in the only opinion issued by a federal court to consider explicitly the application of GARA to an accident that occurred abroad. *See Alter v. Bell Helicopter Textron, Inc.,* 944 F.Supp. 531 (S.D.Tex.1996).[1] In *Alter,* plaintiffs filed a wrongful death action arising out of a helicopter crash in Israel. *Id.* at 533. Plaintiffs argued that GARA did not apply to bar a suit stemming from an accident occurring in a foreign country. *Id.* at 541. The district court rejected this argument, noting that all of the cases applying the presumption against extraterritoriality dealt with statutes that create a cause of action rather than statutes that preclude claims. *Id.* (finding no "authority which holds that a federal statute barring enforcement of claims in courts of the United States bars only claims arising within the United States").[2] The court further pointed out that "[p]laintiff's interpretation of GARA would have the anomalous effect of preventing litigants from bringing an action in the United States for an accident occurring in the United States while allowing litigants to bring the same action in the United States if the accident occurred abroad." *Id.* We find this reasoning persuasive and supportive of our holding that a statute that does not regulate conduct occurring abroad does not implicate the presumption against extraterritoriality.

Our approach is consistent with the case law applying the presumption against extraterritoriality. Uniformly, the cases invoke the presumption when applying a statute would have the effect of regulating specific conduct occurring abroad. *See Sale v. Haitian Ctrs. Council, Inc.,* 509 U.S. 155, 173–74, 113 S.Ct. 2549, 125 L.Ed.2d 128 (1993) (deportation of aliens from international waters); *Smith,* 507 U.S. at 203–04, 113 S.Ct. 1178(federal tort claims arising in Antarctica);

Aramco, 499 U.S. at 248–51, 111 S.Ct. 1227 (employment discrimination in Saudi Arabia); *Foley Bros. v. Filardo,* 336 U.S. 281, 285–86, 69 S.Ct. 575, 93 L.Ed. 680 (1949) (minimum overtime pay provisions for employees working in Iraq and Iran); *United States v. Palmer,* 16 U.S. (3 Wheat.) 610, 4 L.Ed. 471 (1818) (anti-piracy laws in international waters); *ARC Ecology,* 411 F.3d at 1097 (environmental assessment in Philippines); *Gushi Bros. Co. v. Bank of Guam,* 28 F.3d 1535, 1542–43 (9th Cir.1994) (banking regulation in Marshall Islands); *Subafilms, Ltd. v. MGM–Pathe Commc'ns Co.,* 24 F.3d 1088, 1095–97 (9th Cir.1994) (en banc) (copyright infringement in foreign distribution of films).

[9] On the other hand, when a statute regulates conduct that occurs within the United States, the presumption does not apply. *See Pakootas,* 452 F.3d at 1077–78(holding that, since the Comprehensive ***955** Environmental Response, Compensation, and Liability Act regulates the actual release of hazardous materials, no issue of extraterritoriality arises when a company arranged for disposal in Canada of hazardous substances, but the release itself occurred within the United States). Here, Congress passed a statute regulating the ability of a party to bring a suit against a general aviation aircraft manufacturer in American courts. Following these cases, GARA itself does not regulate any conduct that occurred abroad, so the presumption does not apply.

Despite appellants' assertions, the Second Circuit's opinion in *Kollias v. D & G Marine Maintenance,* 29 F.3d 67 (2d Cir.1994), does not compel a contrary result. The *Kollias* court grappled with the issue of whether the Longshore and Harbor Workers' Compensation Act ("LHWCA") applied in a suit brought by an employee injured on the high seas. *Id.* at 68. The court held that the presumption did apply, *id.* at 72, but that it was overcome by Congress's clear indication that it intended for the LHWCA to apply outside the United States. *Id.* at 73. Appellants rely on dicta in *Kollias* noting that all statutes, "without exception, be construed to apply within the United States only, unless a contrary intent appears." *Id.* at 71. The court made this statement in response to the defendants' contention that the presumption against extraterritoriality should categorically not apply to maritime legislation. *Id.* Contrary to appellants' assertions, our holding will not create any exception to the presumption. Rather, if a statute does not regulate conduct occurring abroad, then the presumption against extraterritoriality is not even implicated. This is entirely consistent with the Second Circuit's reasoning in *Kollias,* where the court invoked the presumption when the statute at issue governed conduct that took place in international waters. *See id.* at 70–73.

CONCLUSION

For the foregoing reasons, we affirm the district court's final judgment.

AFFIRMED.

All Citations

522 F.3d 948, Prod.Liab.Rep. (CCH) P 17,969, 08 Cal. Daily Op. Serv. 4160, 2008 Daily Journal D.A.R. 5133

Footnotes

[*] The Honorable Robert J. Timlin, Senior United States District Judge for the Central District of California, sitting by designation.

[1] Other courts have held that GARA applies to bar suit in American courts stemming from foreign accidents, but without expressly discussing the presumption against extraterritoriality. *See Bain ex rel. Bain v. Honeywell Int'l, Inc.,* 167 F.Supp.2d 932, 937 (E.D.Tex.2001) (GARA bars tort claims brought by survivors of victim who died in a helicopter crash in Canada); *Campbell v. Parker–Hannifin Corp.,* 69 Cal.App.4th 1534, 82 Cal.Rptr.2d 202, 209–10 (1999) (GARA barred claim arising out of accident occurring in Australia).

[2] We emphasize that our decision is not premised on a categorical distinction between a remedial and defensive statute. Rather, the inquiry goes to whether a specific statute's application would effectively regulate conduct occurring abroad.

End of Document

TAB 70

830 F.2d 1009
United States Court of Appeals,
Ninth Circuit.

BOARD OF TRUSTEES OF the WESTERN CONFERENCE OF TEAMSTERS PENSION TRUST FUND, Plaintiff-Appellant,
v.
H.F. JOHNSON, INC.; Midland Terminal Inc.; Lockwood Leasing Company; Rocky Mountain Feed Ingredients Services Inc.; First Trust Company of Montana, in its Capacity as Personal Representative of the Estate of Robert L. Mitchell for the Benefit of Sara Jayne Mitchell and Trevor Robert Newton Mitchell, and Richard L. Mitchell, Defendants-Appellees.

No. 86–4394.
|
Argued and Submitted Aug. 6, 1987.
|
Decided Oct. 16, 1987.

Board of trustees of multiemployer pension plan filed suit to enforce its determination of withdrawal liability of employer which had withdrawn from plan. On parties' motion for summary judgment, the United States District Court for the Western District of Washington, Walter T. McGovern, Chief Judge, 606 F.Supp. 231, held joint venturers could not be held personally liable for withdrawal obligations and that Montana nonclaim statute governing actions against decedents' estates barred fund's action to collect withdrawal liability under ERISA from estate of deceased joint venturer. The Court of Appeals, Beezer, Circuit Judge, held that: (1) principals in joint venture could be held personally liable for joint venturer's withdrawal liability, subject to exemption for assets protected under Bankruptcy Code; (2) cause of action under MPPAA survived death of principal in joint venture; and (3) Montana's nonclaim statute was preempted by ERISA.

Reversed.

West Codenotes

Limited on Preemption Grounds
Mont. Code Ann. 72-3-803.

Attorneys and Law Firms

***1011** Bruce D. Corker and Christopher J. Biencourt, Perkins Coie, Seattle, Wash., for plaintiff-appellant Bd. of Trustees.

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Jon E. Doak, Billings, Mont., for defendant-appellee Richard Mitchell.

Jeanne K. Beck, Washington D.C., for amicus curiae Pension Benefit Guar. Corp.

Appeal from the United States District Court for the Western District of Washington.

Before CANBY, REINHARDT and BEEZER, Circuit Judges.

Opinion

BEEZER, Circuit Judge:

The Board of Trustees of the Western Conference of Teamsters Pension Trust Fund (The Fund) appeals the district court's decision 1) that joint venturers may not be held personally liable for their business's withdrawal obligations under the Multiemployer Pension Plan Amendments to the Employee Retirement Income Security Act (ERISA), and 2) that the Montana non-claim statute governing actions against decedents' estates bars the Fund's action to collect withdrawal liability under ERISA from the estate of a deceased joint venturer. We reverse the judgment on both issues.

I

Background

The Fund is a multiemployer pension fund, administered under ERISA, 29 U.S.C. § 1001 et seq., for the benefit of employees represented by the Western Conference of Teamsters. Employers participating in the Fund must pay regular contributions based on wages earned and hours worked by employees.

The Fund in this case is a "defined benefit" fund. In such funds, benefits vested in employees typically exceed total contributions made by an employer on behalf of those employees. *See Connolly v. Pension Benefit Guaranty Corp.,* 581 F.2d 729, 733 (9th Cir.1978), *cert. denied,* 440 U.S. 935, 99 S.Ct. 1278, 59 L.Ed.2d 492 (1979). In order to prevent employers from withdrawing from multiemployer funds before contributions are sufficient to cover vested benefits, Congress enacted the Multiemployer Pension Plan Amendments Act ***1012** (MPPAA). MPPAA requires employers who cease to participate in multiemployer funds to pay "withdrawal liability" based on the difference between actual contributions and vested benefits of employees. Under ERISA 29 U.S.C. § 1301(b)(1), all entities under common control of 5 or fewer persons are liable for a single entity's withdrawal liability. The control group is considered a single employer. *Id.*

Robert and Richard Mitchell were each 49.5% shareholders in H.F. Johnson, Inc. H.F. Johnson withdrew from the Fund in 1981. When H.F. Johnson failed to pay its withdrawal obligation, the Fund sued and obtained judgment against the corporation for the amount of the obligation. *Board of Trustees Etc. v. H.F. Johnson,* 606 F.Supp. 231 (W.D.Wash.1985). H.F. Johnson is not a party to this appeal.

While attempting to enforce the judgment, the Fund discovered that Robert and Richard Mitchell were also joint venturers with a 99% interest in Lockwood Leasing Company. The parties concede that Lockwood and H.F. Johnson were under the common control of Robert and Richard Mitchell.

Robert Mitchell died June 20, 1984. On October 1, 1985, the Fund sued Lockwood, Richard Mitchell, and First Trust Company of Montana (personal representative of Robert's estate) for H.F. Johnson's withdrawal liability.

The District Court Decision

On cross motions for summary judgment, the district court held that Lockwood was liable as a commonly controlled entity for H.F. Johnson's withdrawal liability. Lockwood does not appeal. The court further held that neither Robert Mitchell's Estate nor Richard Mitchell could be held liable for Lockwood's obligation based on their status as joint venturers in Lockwood and, in any event, that the Montana nonclaim statute barred the Fund's action against First Trust as personal representative of Robert's estate. The Fund appeals.

II

Jurisdiction

The district court had jurisdiction under 29 U.S.C. § 1451(c). Federal Rule of Civil Procedure 58 requires the clerk of the district court to enter judgment according to the decision of the district court in a separate document. The district court docket sheet indicates that no separate judgment concerning First Trust, Richard Mitchell or Lockwood has been entered.[1]

The separate judgment rule of Rule 58 is not jurisdictional and may be waived, either expressly or by implication. *Bankers Trust Co. v. Mallis,* 435 U.S. 381, 383–84, 98 S.Ct. 1117, 1119–20, 55 L.Ed.2d 357 (1978); *Vernon v. Heckler,* 811 F.2d 1274, 1276–77 (9th Cir.1987). The Fund has expressly waived application of the separate judgment rule in this case.

[1] The district court granted First Trust's and Richard's motions for summary judgment on November 6, 1986. The Fund filed a notice of appeal on December 4, 1986. This appeal is timely. We have jurisdiction under 28 U.S.C. § 1291.

III

Analysis

A. *Withdrawal Liability of Lockwood Under 29 U.S.C. § 1301(b)(1)*

Lockwood does not appeal the district court's ruling that Lockwood is jointly liable as an employer for H.F. Johnson's withdrawal liability. However, Richard and First Trust contend that imposition of withdrawal liability on Lockwood (and themselves by virtue of their participation in Lockwood) violates the Due Process Clause of the Fifth Amendment.[2]

***1013** 1. The Statutory Scheme

MPPAA, 29 U.S.C. § 1381 provides that, when an employer withdraws from a multiemployer plan, "the employer is liable to the plan in the amount determined under this part to be the withdrawal liability." Section § 1301(b)(1) provides that "[f]or purposes of this subchapter ... businesses (whether incorporated or unincorporated) which are under common control shall be treated ... as a single employer." 29 U.S.C. § 1301(b)(1).

[2] Congress enacted section 1301 in 1974 as part of subchapter III of ERISA. The withdrawal liability provisions, 29 U.S.C. §§ 1381 et seq., were added to the same subchapter by MPPAA. MPPAA also amended § 1301(a). Subsection (b) of § 1301 (the common control provision) was purposely left unchanged. *See* 126 Cong.Rec. S11672 (Aug. 26, 1980) (Remarks of Senator Williams). The plain language of § 1301(b) indicates that businesses under common control are to be treated as a single employer for purposes of withdrawal liability (29 U.S.C. § 1381).[3] Lockwood is liable under §§ 1301 and 1381 as a commonly controlled entity for H.F. Johnson's withdrawal liability.

2. Due Process

First Trust and Richard contend that § 1301(b) violates Due Process unless the Plan can show that Lockwood derived some benefit from association with H.F. Johnson. First Trust and Richard assert injury to economic interests. Where economic interests are at stake, "the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way." *Usery v. Turner Elkhorn Mining Co.,* 428 U.S. 1, 15, 96 S.Ct. 2882, 2892, 49 L.Ed.2d 752 (1976). Beyond simple rationality, no particular degree of relation between the end of economic legislation and the means used to further the end is required. *See, e.g., Wickard v. Filburn,* 317 U.S. 111, 63 S.Ct. 82, 87 L.Ed. 122 (1942).

[3] Congress enacted § 1301(b) in order to prevent businesses from shirking their ERISA obligations by fractionalizing operations into many separate entities:

> the committee ... intends to make it clear that the coverage and antidiscrimination provisions cannot be avoided by operating through separate corporations instead of separate branches of one corporation.

S.Rep. No. 383, 93d Cong., 2d Sess. 43, *reprinted in* 1974 U.S. Code Cong. & Ad. News 4639, 4890, 4928; *see also* H.Rep. No. 807, 93d Cong., 2d Sess. 50, *reprinted in* 1974 U.S. Code Cong. & Ad. News, 4670, 4716; *Center City Motors,* 609 F.Supp. at 412. Joint liability for commonly controlled businesses is a rational means for preventing dispersion of assets used in a common enterprise. *See Ouimet II,* 711 F.2d at 1089.

[4] First Trust and Richard also claim that § 1301(b) violates procedural requirements of the Due Process Clause because the Fund did not sue Lockwood, First Trust and Richard until after the Fund had obtained judgment for withdrawal liability against H.F. Johnson. However, the requirement of common control in § 1301(b) assures that individuals and entities who may ultimately be held liable for withdrawal liability in fact have notice and an opportunity to contest the existence and extent of that liability.

***1014** Section 1301(b) does not violate substantive or procedural Due process.

B. *Personal Withdrawal Liability For Joint Venturers Under ERISA*

The Fund asserts that the Robert Mitchell Estate and Richard Mitchell are personally liable as joint venturers in Lockwood. First Trust and Richard do not challenge the district court's finding that Lockwood is a joint venture.

Congress did not preclude the possibility of individual liability under MPPAA. Section 1381 is silent as to whether persons other than employers may be liable for withdrawal payments. However, 29 U.S.C. § 1405(c) provides

> [t]o the extent that the withdrawal liability of an employer is attributable to his obligation to contribute to or under a plan as an individual (*whether as a sole proprietor or as a member of a partnership*), property which may be exempt from the estate under section 522 of Title 11 or under similar provisions of law, shall not be subject to enforcement of such liability.

(emphasis added).

Section 1405(c) protects only those assets which would be exempt under the bankruptcy code from being used to satisfy withdrawal liability of partners and sole proprietors. Other personal non-business assets of an individual which are not exempt under the bankruptcy code *may* be liquidated to satisfy a partner's or sole proprietor's withdrawal liability. The legislative history of § 1451(c) confirms this view:

> *The Committees recognize that some employers that are obligated to contribute to multiemployer plans are individuals, i.e. sole proprietors or partners.* The Committees believe that if such an employer withdraws from a multiemployer plan, *some of the employer's personal assets,* such as his residence, should be shielded from employer liability. A special rule provides that where the withdrawn employer is an individual, the employer's personal assets that would be exempt under bankruptcy law will be protected from employer liability.

126 Cong.Rec. S20195 (daily ed. July 29, 1980) (emphasis added).

1. Applicable Law

Although MPPAA contemplates individual withdrawal liability where the employer is a sole proprietorship or partnership, MPPAA does not expressly create such liability. MPPAA provides that an employer's failure to pay withdrawal liability "shall be treated in the same manner as a delinquent contribution (within the meaning of section 1145 of this title)." 29 U.S.C. § 1451(b).

While we may look to state law for guidance, *Laborers Clean-up Contract Administration Trust Fund v. Uriarte Clean-up Service, Inc.,* 736 F.2d 516, 523 (9th Cir.1984), the question of whether the Robert Mitchell Estate and Richard Mitchell are liable for Lockwood's withdrawal liability is ultimately one of federal law. Congress "intended that a body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans." 120 Cong.Rec. 29942 (1974) (Remarks of Senator Javits); *see Massachusetts Mutual Life Insurance Co. v. Russell,* 473 U.S. 134, 156, 105 S.Ct. 3085, 3098, 87 L.Ed.2d 96 (1974) (Brennan, J. concurring).

2. Common Law of Joint Venturer Liability

[5] Whether the principals in joint ventures may be held personally liable for a joint venture's withdrawal liability is a question of first impression in this Circuit. This is a question of law, which the Court reviews *de novo. See, e.g., Seymour v. Hull & Moreland Engineering,* 605 F.2d 1105, 1109–11 (9th Cir.1979) (deciding *de novo* whether shareholders and officers may be held personally liable for corporation's obligations under LMRA).

[6] Joint venturers are treated the same as general partners for tax purposes. 26 U.S.C. § 7701(a)(2); ***1015** *Schaffer v. Commissioner of Internal Revenue,* 779 F.2d 849, 852 (2d Cir.1985). The Department of Treasury has specifically applied this definition in the context of ERISA liability. 26 C.F.R. § 11.414(c)–2(a). Commentators generally regard joint ventures as a sub-species of partnership. *See, e.g., H. Reuschlein, W. Gregory, Agency and Partnership, § 266* (1979). "As a general rule the substantive law of partnerships is applicable in determining the rights and liabilities of joint venturers...." *Stone v. First Wyoming Bank,* 625 F.2d 332, 340 (10th Cir.1980); *see Decker Coal Co. v. Commonwealth Edison Co.,* 714 P.2d 155, 156 (Mont.1986) ("Under Montana law a joint venture ... is treated like a partnership.")

[7] Absent any limitation in the partnership agreement, partners are personally liable for obligations of the partnership. *Uniform Partnership Act § 17.* In *United Food & Commercial Workers Union v. Progressive Supermarkets,* 644 F.Supp. 633, 642 (D.N.J.1986) and *Connors v. Calvert Development Co.,* 622 F.Supp. 877 (D.D.C.1985), district courts allowed recovery of withdrawal liability from partners and partnerships under common control with defaulting corporate employers. We hold that Robert Mitchell's Estate and Richard Mitchell are personally liable as joint venturers for Lockwood's withdrawal obligation.

First Trust and Richard rely on decisions which have held shareholders and officers not personally liable for withdrawal obligations of corporations. The fundamental difference between corporations and partnerships, (i.e., shareholders and officers enjoy limited liability; partners do not) makes these precedents inapplicable to this case. [4]

[8] First Trust and Richard contend that § 1405(c), in protecting assets exempt under the bankruptcy code, limits withdrawal liability only for persons who are obliged "to contribute to or under a plan as an individual." 29 U.S.C. § 1405(c). As a result, the argument goes, liability for individuals who do not have a "direct" obligation to contribute to pension funds would, perversely, extend to all assets without limit. We reject this narrow reading of § 1405(c). That MPPAA does not specify the liability of individual joint venturers does not mean that their liability, if found to exist, must extend to all assets without limit.

Section 1301(b) provides that businesses under common control "shall be treated ... as a single employer." Although H.F. Johnson initially defaulted on its withdrawal liability, Lockwood is, for purposes of this lawsuit, a defaulting employer. Had H.F. Johnson failed to contribute to the Fund, Lockwood, Robert Mitchell's Estate and Richard Mitchell would have had a personal obligation to contribute to the Fund by virtue of § 1301(b) and the common law of joint venturer liability. The exemption contained in § 1405(c) applies to Robert Mitchell's Estate and Richard Mitchell.

The district court's central concern appears to have been that holding Richard Mitchell and Robert Mitchell's Estate liable as joint venturers in Lockwood would create an "end run" around protection afforded First Trust and Richard as shareholders in H.F. Johnson. However, the decision to forgo the benefits of incorporation and to establish Lockwood as a joint venture was presumptively made for business reasons and for the personal benefit of Richard and Robert. They (and their successors in interest) are responsible for whatever legal consequences attach to their own choice of business organization.

Robert Mitchell's Estate and Richard Mitchell are personally liable for Lockwood's obligation under §§ 1301(b)(1), 1381, subject to the exemption provided by § 1405(c).

C. *Survival of Cause of Action*

[9] First Trust contends that §§ 1381 and 1451(f) do not apply to this case because MPPAA "does not expressly provide ***1016** an independent cause of action against a decedent's estate." MPPAA neither authorizes nor precludes such actions. Whether MPPAA transcends death is a question of federal common law.

[10] At early common law, creditors could not sue the estate of one who had a joint contractual obligation. *Davis v. Van Buren,* 72 N.Y. 587 (1878); *McLaughlin v. Head,* 86 Or. 361, 168 P. 614 (1917); 2 *Williston on Contracts, § 344.* This rule has been abolished in most states. *See, e.g.,* Mont. Code Ann. § 27–1–501 ("An action, cause of action, or defense does not abate because of the death or disability of a party...."); J. Callamari, J. Perillo, *The Law of Contracts* at 745 (1977). Under ordinary principles of survival of actions, the Fund may pursue a decedent's estate just as it may pursue the living, provided that suit is brought within the appropriate period of limitations. *See Trustees of Central Laborers' Pension Fund v. Tisler,* 641 F.Supp. 389, 390–93 (C.D.Ill.1986) (action against decedent's estate for unpaid fringe benefits); *Connors v. Calvert Development Co.,* 622 F.Supp. 877, 882 (D.D.C.1985).

D. *Preemption of Montana's Nonclaim Statute*

The Montana Probate Code provides that claims arising before death against a decedent "are barred against the estate, the personal representative, and the heirs and devisees of the decedent unless presented ... within 4 months" after publication of notice to creditors. Mont.Code Ann. § 72–3–803. [5] The Fund admits that its claim against Robert Mitchell's Estate is barred by Montana law unless the period for presentation of claims was tolled by Robert Mitchell's alleged fraud. The Fund contends, however, that ERISA preempts the Montana statute and that the claim against the Estate is not barred. We agree.

[11] With limited exceptions not relevant to this discussion, ERISA "supersede[s] any and all State laws insofar as they ... relate to any employee benefit plan...." 29 U.S.C. § 1144(a). A law "relates to" an ERISA plan if it "has a connection with or reference to such a plan." *Shaw v. Delta Air Lines,* 463 U.S. 85, 98, 103 S.Ct. 2890, 2900, 77 L.Ed.2d 490 (1983). ERISA preemption is to be construed broadly, and is not limited to state laws designed specifically to affect employee benefit plans. *Pilot Life Insurance Co. v. Dedeaux,* 481 U.S. 41, 107 S.Ct. 1549, 1552–53, 95 L.Ed.2d 39 (1987); *Shaw,* 463 U.S. 85, 103 S.Ct. 2890, 77 L.Ed.2d 490 (1983). As the Court stated in *Pilot Life,* "The question whether a certain state action is preempted by federal law is one of congressional intent. The purpose of Congress is the ultimate touchstone." 107 S.Ct. at 1552 (citations, quotation marks and brackets omitted).

That Congress expressly provided a period of limitations governing actions to collect withdrawal liability (29 U.S.C. § 1451(f)) indicates that Congress considered the period of limitations applicable to such actions essential to enforcement of employer obligations under MPPAA. Montana Probate Code § 72–3–803, as it applies to this case, adds a condition not contemplated by Congress to collection of withdrawal liability. Montana's non-claim statute plainly "relates to" the Fund, and is preempted under ERISA, 29 U.S.C. § 1144(a). The Fund's suit against Robert Mitchell's Estate was timely.

Our conclusion is consistent with the general law concerning federal preemption of state statutes of limitation: "[I]t is well established that federal claims are subject to state statutes of limitations unless there is a federal statute of limitations or a conflict with federal policy." *South Carolina v. Catawba Indian Tribe, Inc.,* 476 U.S. 498, 106 S.Ct. 2039, 2044, 90 L.Ed.2d 490 (1986) (footnote omitted). "If Congress explicitly puts a limit upon the time for enforcing ***1017** a right which it created, there is an end of the matter. The Congressional statute of limitation is definitive." *Holmberg v. Armbrecht,* 327 U.S. 392, 395, 66 S.Ct. 582, 584, 90 L.Ed. 743 (1946).[6]

IV

Conclusion

We are faced with the awkward task of developing a coherent body of federal common law around specific statutory provisions which were not designed with these circumstances in mind. The potentially disruptive effect of our decision on probate of decedents' estates—an area of special concern to states—can hardly be understated.[7] Our decision is the product of expansive statutory liability, sweeping preemption and a Congressional mandate for creation of federal common law. Disruptive or not, our interpretation of the Act and our formulation of federal common law follow clearly from the congressional dictates in ERISA.

We hold as follows:

Imposition of liability on Lockwood for H.F. Johnson's default does not violate Due Process. Robert Mitchell and Richard Mitchell are liable, subject to section 1405(c) exemptions, as joint venturers in Lockwood for Lockwood's obligation to pay H.F. Johnson's withdrawal liability. Robert Mitchell's Estate is liable for Robert Mitchell's Lockwood's withdrawal liability. MPPAA preempts Montana Probate Code § 72–3–803 insofar as § 72–3–803 places a shorter period of limitations on actions to enforce withdrawal liability than 29 U.S.C. § 1451(f). The judgment is reversed.

REVERSED.

All Citations

830 F.2d 1009, 56 USLW 2257, 8 Employee Benefits Cas. 2593

Footnotes

[1] The record contains several other judgments pertaining to other entities involved at the district court level, none of which pertain to Lockwood, First Trust, or Richard Mitchell.

[2] First Trust and Richard have a direct financial stake in the determination of whether Lockwood is liable for H.F. Johnson's withdrawal liability. Accordingly, First Trust and Richard have standing to litigate the constitutionality of § 1301. *See Fernandez v. Brock,* 822 F.2d 865, 868–69 (9th Cir.1987); *Morrison-Knudsen Co. v. CHG International, Inc.,* 811 F.2d 1209, 1214 (9th Cir.1987).

[3] The First and Sixth Circuits have held that liability for termination of single-employer benefit plans (29 U.S.C. § 1362) extends to entities under common control as defined by § 1301(b). *In Re Challenge Stamping and Porcelain Co.,* 719 F.2d 146 (6th

Cir.1983); *Pension Benefit Guaranty Corporation v. Ouimet,* 630 F.2d 4, (1st Cir.1980) (*Ouimet I*), *cert. denied,* 450 U.S. 914, 101 S.Ct. 1356, 67 L.Ed.2d 339 (1981), *appeal after remand,* 711 F.2d 1085, *cert. denied* 464 U.S. 961, 104 S.Ct. 393, 78 L.Ed.2d 337 (1983). Several district courts have held businesses liable for a commonly-controlled business' withdrawal liability. *See United Food & Commercial Workers Union v. Progressive Supermarkets,* 644 F.Supp. 633 (D.N.J.1986); *Connors v. Calvert Development Co.,* 622 F.Supp. 877 (D.D.C.1985); *Pension Benefit Guaranty Corp. v. Center City Motors, Inc.,* 609 F.Supp. 409 (S.D.Cal.1984).

[4] Indeed, the principal case relied on by the district court expressly reserved the possibility that shareholders and officers might be liable for a corporation's withdrawal liability under “traditional common law principles” of corporate veil-piercing. *Connors v. P & M Coal Co.,* 801 F.2d 1373, 1378 (D.C.Cir.1986).

[5] “Every claim which is disallowed ... by the personal representative is barred ... unless the claimant files a petition for allowance in the court or commences a proceeding against the personal representative not later than 60 days after mailing of the notice of disallowance....” Mont.Code Ann. § 72–3–805.

[6] *See, e.g.,* 29 U.S.C. § 160 (6 month period of limitations applies to unfair labor practice actions brought by National Labor Relations Board); *Herget v. Central National Bank & Trust Co.,* 324 U.S. 4, 65 S.Ct. 505, 89 L.Ed. 656 (1945) (Bankruptcy Act period of limitations governs actions to set aside preferential transfers); *Continental Enterprises, Inc. v. American Oil Co.,* 808 F.2d 24, 28 (8th Cir.1986) (period of limitations prescribed by 15 U.S.C. § 2806(a) governs action for violation of the Petroleum Marketing Practices Act); *Florasynth, Inc. v. Pickholz,* 750 F.2d 171, 175 (2d Cir.1984) (Arbitration Act period of limitations (9 U.S.C. § 12) governs actions to vacate arbitration award); *United States v. Tilleraas,* 709 F.2d 1088, 1090 (6th Cir.1983) (action pursuant to Higher Education Act to recover student loan governed by 28 U.S.C. § 2416(c)); *Basham v. Finance America Corp.,* 583 F.2d 918, 928 (7th Cir.1978) (federal statute of limitations, 15 U.S.C. § 1640(e) governs action under Truth In Lending Act), *cert. denied,* 439 U.S. 1128, 99 S.Ct. 1046, 59 L.Ed.2d 89 (1979); *LaBelle v. Blue Cross & Blue Shield United of Wisconsin,* 548 F.Supp. 251, (W.D.Wis.1982) (Federal Employees Health Benefits Act of 1959 period of limitations (5 U.S.C. § 8902(m)(1)) governs postal worker's action for payment of insurance benefits); *United States ex rel. Small Business Administration v. Kurtz,* 525 F.Supp. 734, 739–41 (E.D.Pa.1981) (28 U.S.C. § 2415 governs United States' action to recover on guaranty under Small Business Act), *aff'd* 688 F.2d 827 (3rd Cir.1982), *cert. denied,* 459 U.S. 991, 103 S.Ct. 347, 74 L.Ed.2d 387.

[7] We need not decide whether liability extends to transferees of estates because the estate of Robert Mitchell has not yet been distributed, and is, in fact, insolvent. For the same reasons, we need not decide whether fiduciaries charged with settling estates may be liable for distribution of assets after the state non-claims period has run, but before the 6 year period for collection of withdrawal liability has elapsed.

End of Document

TAB 71

106 S.Ct. 1018
Supreme Court of the United States

John L. CONNOLLY, et al., etc., Appellants,
v.
PENSION BENEFIT GUARANTY CORPORATION, etc., et al.
WOODWARD SAND COMPANY, INC., Appellant,
v.
PENSION BENEFIT GUARANTY CORPORATION, etc., et al.

Nos. 84-1555, 84-1567.
|
Argued Dec. 2, 1985.
|
Decided Feb. 26, 1986.

Trustees of multiemployer pension fund brought action challenging constitutionality of withdrawal liability provisions of Multiemployer Pension Plan Amendments Act of 1980. The United States District Court for the Central District of California entered summary judgment in favor of Pension Benefit Guaranty Corporation, but the Ninth Circuit Court of Appeals, 673 F.2d 1110, reversed. On remand, a three-judge panel of the District Court again entered summary judgment in favor of PBGC, upholding constitutionality of provisions, and trustees appealed. The Supreme Court, Justice White, held that imposition of withdrawal liability did not constitute compensable taking under Fifth Amendment taking clause.

Affirmed.

Justice O'Connor concurred and filed opinion in which Justice Powell joined.

****1018 *211** *Syllabus*[*]

The Employee Retirement Income Security Act (ERISA), enacted in 1974, established ****1019** a pension plan termination insurance program whereby the Pension Benefit Guaranty Corporation (PBGC), a wholly owned Government corporation, collects insurance premiums from covered private retirement plans and provides benefits to participants if their plan terminates with insufficient assets to support the guaranteed benefits. The program covers both single-employer and multiemployer pension plans. With respect to the latter plans, ERISA delayed mandatory payment of guaranteed benefits until January 1, 1978, prior to which date the PBGC had discretionary authority to pay benefits upon the termination of a pension plan. As that date approached, Congress became concerned that a significant number of multiemployer plans were experiencing extreme financial hardship, and that implementation of mandatory guarantees might induce several large plans to terminate, thus subjecting the insurance system to liability beyond its means. After further delaying the effective date for the mandatory guarantees, Congress enacted the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) requiring an employer withdrawing from a multiemployer pension plan to pay a fixed and certain debt to the plan amounting to the employer's proportionate share of the plan's "unfunded vested benefits." Appellant trustees administer a multiemployer pension plan for employers under collective-bargaining agreements covering employees in the construction industry in California and Nevada. Under the trust agreement and the plan, the employer's sole obligation is to pay the contributions required by the collective-bargaining agreements, and the employer's obligation for pension benefits is ended when the employer pays the contribution to the pension trust. Prior to enactment of the MPPAA, the trustees filed suit against the PBGC in Federal District Court, claiming, *inter alia,* that ERISA was unconstitutional as depriving the trustees, the employers, and the plan participants of property

***212** without proper compensation. During the course of the litigation, the MPPAA was enacted, and the District Court permitted the trustees to file an amended complaint to include a challenge to that Act. Ultimately, the District Court granted summary judgment in the PBGC's favor, rejecting appellants' argument that imposition of withdrawal liability under the MPPAA violates the Taking Clause of the Fifth Amendment.

Held: The withdrawal liability provisions of the MPPAA do not violate the Taking Clause. Pp. 1024-1028.

(a) In these cases, the United States under the MPPAA has taken nothing for its own use and only has nullified a contractual provision limiting liability by imposing an additional obligation that is otherwise within Congress' power to impose. That the statutory withdrawal liability will operate in this manner and will redound to the benefit of the pension trust does not justify a holding that the withdrawal liability provisions violate the Taking Clause. Pp. 1024-1025.

(b) In identifying a "taking" forbidden by the Taking Clause, three factors should be considered: (1) "the economic impact of the regulation on the claimant"; (2) "the extent to which the regulation has interfered with distinct investment-backed expectations"; and (3) "the character of the governmental action." *Penn Central Transportation Co. v. New York City,* 438 U.S. 104, 124, 98 S.Ct. 2646, 2659, 57 L.Ed.2d 631. Examining the MPPAA in light of these factors supports the conclusion that the imposition of withdrawal liability does not constitute a compensable taking under the Taking Clause. The interference with an employer's property rights resulting from requiring the employer to fund its share of the pension plan obligation arises from a public program that adjusts the benefits and burdens of economic life to promote the common good and does not constitute a taking requiring Government compensation. As to the severity ****1020** of the MPPAA's economic impact, there is nothing to show that the withdrawal liability imposed on an employer will always be out of proportion to its experience with the pension plan. And as to interference with reasonable investment-backed expectations, employers had more than sufficient notice not only that pension plans were being regulated at the time the MPPAA was enacted but also that withdrawal itself might trigger additional financial obligations. Pp. 1025-1028.

631 F.Supp. 640, affirmed.

WHITE, J., delivered the opinion for a unanimous Court. O'CONNOR, J., filed a concurring opinion, in which POWELL, J., joined, *post,* p. ---.

Attorneys and Law Firms

Wayne Jett argued the cause and filed briefs for appellants in No. 84-1555. *Richard M. Freeman* argued the cause for ***213** appellant in No. 84-1567. With him on the brief was *Michael L. Jensen.*

Baruch A. Fellner argued the cause for appellees. With him on the brief were *Edward R. Mackiewicz, Mitchell L. Strickler, J. Stephen Caflisch, Peter H. Gould, David F. Power, Nathan Lewin,* and *Seth P. Waxman.*†

† Briefs of *amici curiae* urging reversal were filed for the American Trucking Associations, Inc., by *Carl L. Taylor, Glenn Summers, Daniel R. Barney,* and *Kenneth E. Siegel;* and for the National Association of Manufacturers by *Chester W. Nosal, John R. Keys, Jr., Columbus R. Gangemi, Jan S. Amundson,* and *Gary D. Lipkin.*

Briefs of *amici curiae* urging affirmance were filed for the National Coordinating Committee for Multiemployer Plans by *Gerald M. Feder;* and for Trustees of the United Mine Workers of America 1950 and 1974 Pension Plans by *William F. Hanrahan* and *Israel Goldowitz.*

William H. Towle filed a brief for the American Warehousemen's Association as *amicus curiae.*

Opinion

Justice WHITE delivered the opinion of the Court.

In *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.,* 467 U.S. 717, 104 S.Ct. 2709, 81 L.Ed.2d 601 (1984), the Court held that retroactive application of the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act of 1980 did not violate the Due Process Clause of the Fifth Amendment. In these cases, we address the question whether the withdrawal liability provisions of the Act are valid under the Clause of the Fifth Amendment that forbids the taking of private property for public use without just compensation.

I

A

The background and legislative history of both the Employee Retirement Income Security Act of 1974 (ERISA), 88 Stat. 829, 29 U.S.C. § 1001 *et seq.,* and the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA or Act), 94 Stat. 1208, 29 U.S.C. §§ 1381-1461, are set forth in detail in *Gray, supra,* at 720-725, 104 S.Ct., at 2713-2715. We therefore only summarize the ***214** relevant portions of that description for purposes of our discussion here.

Congress enacted ERISA in 1974 to provide comprehensive regulation for private pension plans. In addition to prescribing standards for the funding, management, and benefit provisions of these plans, ERISA also established a system of pension benefit insurance. This "comprehensive and reticulated statute" was designed "to ensure that employees and their beneficiaries would not be deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds have been accumulated in the plans.... Congress wanted to guarantee that 'if a worker has been promised a defined pension benefit upon retirement-and if he has fulfilled whatever conditions are required to obtain a vested benefit-he will actually receive it.' " 467 U.S., at 720, 104 S.Ct., at 2713, quoting *Nachman Corp. v. Pension Benefit Guaranty Corporation,* 446 U.S. 359, 361-362, 374-375, 100 S.Ct. 1723, 1726, 1733, 64 L.Ed.2d 354 (1980) (citations omitted).

To achieve this goal of protecting "anticipated retirement benefits," Congress created the Pension Benefit Guaranty Corporation (PBGC), a wholly owned Government corporation, to administer an insurance program for participants in both single-employer and multiemployer pension plans. 29 U.S.C. § 1302 (1976 ed.). For single-employer plans that were in default, ERISA immediately obligated the PBGC to pay benefits. § 1381. With respect to multiemployer plans, ERISA delayed mandatory payment of guaranteed benefits until January 1, 1978. Until that date, Congress gave the PBGC discretionary authority to pay benefits upon the termination of multiemployer pension plans. §§ 1381(c)(2)-(4). As with single-employer plans, all contributors to covered multiemployer plans were assessed insurance premiums payable ****1021** to the PBGC. If the PBGC exercised its discretion to pay benefits upon a plan's termination, all employers that had contributed to the plan during the five years preceding its termination were liable to the PBGC in amounts proportional ***215** to their shares of the plan's contributions during that period, subject to the limitation that any individual employer's liability could not exceed 30% of the employer's net worth. § 1362(b)(2).

During the period between the enactment of ERISA and 1978, when mandatory multiemployer guarantees were due to go into effect, the PBGC extended coverage to numerous plans. "Congress became concerned that a significant number of plans were experiencing extreme financial hardship," *Gray, supra,* 467 U.S., at 721, 104 S.Ct., at 2713, and that implementation of mandatory guarantees for multiemployer plans might induce several large plans to terminate, thus subjecting the insurance system to liability beyond its means. As a result, Congress delayed the effective date for the mandatory guarantees for 18 months, Pub.L. 95-214, 91 Stat. 1501, and directed the PBGC to prepare a report analyzing the problems of multiemployer plans and recommending possible solutions. See S.Rep. No. 95-570, pp. 1-4 (1977), U.S.Code Cong. & Admin.News 1977, pp. 4128, 4130; H.R.Rep. No. 95-706, p. 1 (1977).

The PBGC's Report found, *inter alia,* that "ERISA did not adequately protect plans from the adverse consequences that resulted when individual employers terminate their participation in, or withdraw from, multiemployer plans." *Gray, supra,* at 722, 104 S.Ct., at 2714. The "basic problem," the Report found, was the threat to the solvency and stability of multiemployer plans caused by employer withdrawals, which existing law actually encouraged. Pension Benefit Guaranty Corporation, Multiemployer Study Required by P.L. 95-214, pp. 96-97 (1978) (PBGC Report).[1] As the PBGC's Executive Director explained:

> ***216** "A key problem of ongoing multiemployer plans, especially in declining industries, is the problem of employer withdrawal. Employer withdrawals reduce a plan's contribution base. This pushes the contribution rate for remaining employers to higher and higher levels in order to fund past service liabilities, including liabilities generated by employers no longer participating in the plan, so-called inherited liabilities. The rising costs may encourage-or force-further withdrawals, thereby increasing the inherited liabilities to be funded by an ever decreasing contribution base. This vicious downward spiral may continue until it is no longer reasonable or possible for the pension plan to continue." Pension Plan Termination Insurance Issues: Hearings before the Subcommittee on Oversight of the House Committee on Ways and Means, 95th Cong., 2nd Sess., 22 (1978) (statement of Matthew M. Lind) (hereinafter 1978 Hearings).

"To alleviate the problem of employer withdrawals, the PBGC suggested new rules under which a withdrawing employer would be required to pay whatever share of the plan's unfunded liabilities was attributable to that employer's participation." *Gray,* 467 U.S., at 723, 104 S.Ct., at 2714, citing PBGC Report, at 97-114 (footnote omitted). Again, the PBGC Executive Director explained:

> "To deal with this problem, our report considers an approach under which an ****1022** employer withdrawing from a multiemployer plan would be required to complete funding its fair share of the plan's unfunded liabilities. In ***217** other words, the plan would have a claim against the employer for the inherited liabilities which would otherwise fall upon the remaining employers as a result of the withdrawal....
>
> "We think that such withdrawal liability would, first of all, discourage voluntary withdrawals and curtail the current incentives to flee the plan. Where such withdrawals nonetheless occur, we think that withdrawal liability would cushion the financial impact on the plan." 1978 Hearings, at 23 (statement of Matthew M. Lind).

After 17 months of discussion, Congress agreed with the analysis put forward in the PBGC Report, and drafted legislation which implemented the Report's recommendations. "As enacted, the Act requires that an employer withdrawing from a multiemployer pension plan pay a fixed and certain debt to the pension plan. This withdrawal liability is the employer's proportionate share of the plan's 'unfunded vested benefits,' calculated as the difference between the present value of the vested benefits and the current value of the plan's assets." *Gray, supra,* at 725, 104 S.Ct., at 2715, quoting 29 U.S.C. §§ 1381, 1391.

B

Appellant Trustees administer the Operating Engineers Pension Plan according to a written Agreement Establishing the Operating Engineers Pension Trust, executed in 1960, pursuant to § 302(c)(5) of the Labor Management Relations Act, 1947, 29 U.S.C. § 186(c)(5). App. 29. The Trust receives contributions from several thousand employers under written collective-bargaining agreements covering employees in the construction industry throughout southern California and southern Nevada. Under these collective-bargaining agreements, the employers agree to contribute a certain amount to the Pension Plan, with the actual amount contributed by each employer determined by multiplying their employees' hours of service by a rate specified in the current agreement. See *id.,* at 33-35.

***218** By the express terms of the Trust Agreement, *id.,* at 30-31, and the Plan, *id.,* at 31-32, the employer's sole obligation to the Pension Trust is to pay the contributions required by the collective-bargaining agreement. The Trust Agreement clearly states that the employer's obligation for pension benefits to the employee is ended when the employer pays the appropriate contribution to the Pension Trust.[2] This is true even though the contributions agreed upon are insufficient to pay the benefits under the Plan.[3]

***219** ****1023** In 1975, the Trustees filed suit, seeking declaratory and injunctive relief, claiming that the Pension Plan is a "defined contribution plan" as defined by ERISA, and thus not subject to the jurisdiction of the PBGC.[4] Alternatively, the Trustees argued that if the Plan was subject to the provisions of ERISA requiring premium payments and imposing contingent termination liability, the statute was unconstitutional, as it deprived the Trustees, the employers, and the plan participants of property without due process and without proper compensation.

The District Court granted summary judgment to the Trustees, finding that the Plan was a "defined contribution plan," and enjoining the PBGC from treating it in any other manner. *Connolly v. Pension Benefit Guaranty Corporation,* 419 F.Supp. 737 (CD Cal.1976). The Ninth Circuit reversed and remanded for consideration of the constitutional issues. *Connolly v. Pension Benefit Guaranty Corporation,* 581 F.2d 729 (1978), cert. denied, 440 U.S. 935, 99 S.Ct. 1278, 59 L.Ed.2d 492 (1979). On remand, the District Court denied the Trustees' motion to convene a three-judge court on the ground that the Trustees' constitutional challenges were insubstantial. App. 55-56. The Trustees sought a petition of mandamus on the issue, but their petition was denied by both the Ninth Circuit and this Court. ***220** *Connolly v. Williams,* No. 79-7580 (Jan. 14, 1980); *Connolly v. United States District Court,* 445 U.S. 959, 100 S.Ct. 1667, 64 L.Ed.2d 250 (1980).

On the merits, the District Court granted summary judgment to the PBGC, but the Ninth Circuit reversed. 673 F.2d 1110 (1982). The court could not agree with the District Court that the constitutional claims raised by the Trustees were so "insubstantial" that a three-judge panel could be summarily denied. *Id.,* at 1114. The Ninth Circuit remanded the case with directions to convene a three-judge court.

During the course of the litigation to convene the three-judge court, Congress enacted the MPPAA. The District Court permitted the Trustees to file an amended complaint to include a challenge to the constitutionality of the new Act. The court also permitted appellant Woodward Sand Co., an employer that had been assessed withdrawal liability by the Trustees, to intervene in the action. App. 82.[5]

After oral argument, the three-judge panel granted summary judgment in favor of the PBGC. The court rejected appellants' argument that the Act violated the Taking Clause of the Fifth Amendment, ****1024** holding that "the contractual right which insulates employers from further liability to the pension plans in which they participate is not 'property' within the meaning of the takings clause." 631 F.Supp. 640, 645 (1984). Because the court resolved this issue "on the basis that no 'property' is affected by the MPPAA," it did not discuss whether a "taking" had occurred, or whether the taking would have been for a "public purpose." *Ibid.*[6]

***221** Both the Trustees and Woodward Sand Co. invoked the appellate jurisdiction of this Court under 28 U.S.C. § 1253. We noted probable jurisdiction, 472 U.S. 1006, 105 S.Ct. 2699, 86 L.Ed.2d 716 (1985), and now affirm.

II

[1] Appellants challenge the District Court's conclusion that the Act does not effect a taking of "property" within the meaning of the Taking Clause of the Fifth Amendment. Rather than specifically asserting that the contractual limitation of liability is property, however, appellants argue that the imposition of noncontractual withdrawal liability violates the Taking Clause by requiring employers to transfer their assets for the private use of pension trusts and, in any event, by requiring an uncompensated transfer.[7]

***222** We agree that an employer subject to withdrawal liability is permanently deprived ****1025** of those assets necessary to satisfy its statutory obligation, not to the Government, but to a pension trust. If liability is assessed under the Act, it constitutes a real debt that the employer must satisfy, and it is not an obligation which can be considered insubstantial. In the present litigation, for example, appellant Woodward Sand Co.'s withdrawal liability, after the Trustees' assessment was reduced by an arbitrator, was approximately $200,000, or nearly 25% of the firm's net worth. Juris. Statement in No. 84-1567, p. 7, n. 7.

[2] But appellants' submission-that such a statutory liability to a private party always constitutes an uncompensated taking prohibited by the Fifth Amendment-if accepted, would ***223** prove too much. In the course of regulating commercial and other human affairs, Congress routinely creates burdens for some that directly benefit others. For example, Congress may set minimum wages, control prices, or create causes of action that did not previously exist. Given the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another. In *Usery v. Turner Elkhorn Mining Co.,* 428 U.S. 1, 96 S.Ct. 2882, 49 L.Ed.2d 752 (1976), we sustained a statute requiring coal mine operators to compensate former employees disabled by pneumoconiosis, even though the operators had never contracted for such liability, and the employees involved had long since terminated their connection with the industry. We said: "[O]ur cases are clear that legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations.... This is true even though the effect of the legislation is to impose a new duty or liability based on past acts." *Id.,* at 15-16, 96 S.Ct., 2892-2893 (citations omitted).

Relying on *Turner Elkhorn,* we also rejected a due process attack on the imposition, under the statute now before us, of withdrawal liability on employers who withdrew before the effective date of the 1978 amendments. We held that Congress had acted within its powers and for sound reasons. *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.,* 467 U.S. 717, 104 S.Ct. 2709, 81 L.Ed.2d 601 (1984). Although both *Gray* and *Turner Elkhorn* were due process cases, it would be surprising indeed to discover now that in both cases Congress unconstitutionally had taken the assets of the employers there involved.

Appellants' claim of an illegal taking gains nothing from the fact that the employer in the present litigation was protected by the terms of its contract from any liability beyond the specified contributions to which it had agreed. See nn. 2, 3, *supra.* "Contracts, however express, cannot fetter the constitutional authority of Congress. Contracts may create rights of property, but when contracts deal with a subject ***224** matter which lies within the control of Congress, they have a congenital infirmity. Parties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them." *Norman v. Baltimore & Ohio R. Co.,* 294 U.S. 240, 307-308, 55 S.Ct. 407, 415-16, 79 L.Ed. 885 (1935).

[3] **[4]** If the regulatory statute is otherwise within the powers of Congress, therefore, its application may not be defeated by private contractual provisions. For the same reason, the fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an illegal taking. *Bowles v. Willingham,* 321 U.S. 503, 517, 64 S.Ct. 641, 648, 88 L.Ed. 892 (1944); *Omnia Commercial Co. v. United States,* 261 U.S. 502, 508-510, 43 S.Ct. 437, 438, 67 L.Ed. 772 (1923). This is not to say that contractual rights are never property rights or that the Government may always take them for its own benefit without compensation. But here, the United States has taken nothing for its own use, and only has nullified a contractual provision limiting liability by imposing an additional obligation that is ****1026** otherwise within the power of Congress to impose. That the statutory withdrawal liability will operate in this manner and will redound to the benefit of pension trusts does not justify a holding that the provision violates the Taking Clause and is invalid on its face.

[5] This conclusion is not inconsistent with our prior Taking Clause cases. See, *e.g., Ruckelshaus v. Monsanto Co.,* 467 U.S. 986, 104 S.Ct. 2862, 81 L.Ed.2d 815 (1984); *Loretto v. Teleprompter Manhattan CATV Corp.,* 458 U.S. 419, 102 S.Ct. 3164, 73 L.Ed.2d 868 (1982); *Hodel v. Virginia Surface Mining & Reclamation Assn.,* 452 U.S. 264, 101 S.Ct. 2352, 69 L.Ed.2d 1 (1981); *Kaiser Aetna v. United States,* 444 U.S. 164, 100 S.Ct. 383, 62 L.Ed.2d 332 (1979); *Penn Central Transportation Co. v. New York City,* 438 U.S. 104, 98 S.Ct. 2646, 57 L.Ed.2d 631 (1978). In all of these cases, we have eschewed the development of any set formula for identifying a "taking" forbidden by the Fifth Amendment, and have relied instead on ad hoc, factual inquiries into the circumstances of each particular case. *Monsanto Co., supra,* 467 U.S., at 1005, 104 S.Ct., at 2874; *Kaiser Aetna, supra,* 444 U.S., at 175, 100 S.Ct., at 390. To aid in this determination, however, we have identified ***225** three factors which have "particular significance": (1) "the economic impact of the regulation on the claimant"; (2) "the extent to which the regulation has interfered with distinct investment-backed expectations"; and (3) "the character of the governmental action." *Penn Central Transportation Co., supra,* 438 U.S., at 124, 98 S.Ct., at 2659. Accord, *Monsanto Co., supra,* at 1005, 104 S.Ct., at 2874; *PruneYard Shopping Center v. Robins,* 447 U.S. 74, 82-83, 100 S.Ct. 2035, 2041-42, 64 L.Ed.2d 741 (1980). Examining the MPPAA in light of these factors reinforces our belief that the imposition of withdrawal liability does not constitute a compensable taking under the Fifth Amendment.

First, with respect to the nature of the governmental action, we already have noted that, under the Act, the Government does not physically invade or permanently appropriate any of the employer's assets for its own use. Instead, the Act safeguards the participants in multiemployer pension plans by requiring a withdrawing employer to fund its share of the plan obligations incurred during its association with the plan. This interference with the property rights of an employer arises from a public program that adjusts the benefits and burdens of economic life to promote the common good and, under our cases, does not constitute a taking requiring Government compensation. *Penn Central Transportation Co., supra,* 438 U.S., at 124, 98 S.Ct., at 2659; *Usery v. Turner Elkhorn Mining Co., supra,* 428 U.S., at 15, 16, 96 S.Ct., at 2892-93. See *Andrus v. Allard,* 444 U.S. 51, 65, 100 S.Ct. 318, 326-27, 62 L.Ed.2d 210 (1979); *Pennsylvania Coal Co. v. Mahon,* 260 U.S. 393, 413, 43 S.Ct. 158, 159, 67 L.Ed. 322 (1922).

Next, as to the severity of the economic impact of the MPPAA, there is no doubt that the Act completely deprives an employer of whatever amount of money it is obligated to pay to fulfill its statutory liability. The assessment of withdrawal liability is not made in a vacuum, however, but directly depends on the relationship between the employer and the plan to which it had made contributions. Moreover, there are a significant number of provisions in the Act that moderate and mitigate the economic impact of an individual ***226** employer's liability.[8] There is nothing ****1027** to show that the withdrawal liability actually imposed on an employer will always be out of proportion to its experience with the plan, and the mere fact that the employer must pay money to comply with the Act is but a necessary consequence of the MPPAA's regulatory scheme.

The final inquiry suggested for determining whether the Act constitutes a "taking" under the Fifth Amendment is whether the MPPAA has interfered with reasonable investment-backed expectations. Appellants argue that the only monetary obligations incurred by each employer involved in the Operating Engineers Pension Plan arose from the specific terms of the Plan and Trust Agreement between the employers and the union, and that the imposition of withdrawal liability upsets those reasonable expectations. Pension plans, however, were the objects of legislative concern long before the passage of ERISA in 1974, and ***227** surely as of that time, it was clear that if the PBGC exercised its discretion to pay benefits upon the termination of a multiemployer pension plan, employers who had contributed to the plan during the preceding five years were liable for their proportionate share of the plan's contributions during that period. 29 U.S.C. § 1364. It was also plain enough that the purpose of imposing withdrawal liability was to ensure that employees would receive the benefits promised them. When it became evident that ERISA fell short of achieving this end, Congress adopted the 1980 amendments. Prudent employers then had more than sufficient notice not only that pension plans were currently regulated, but also that withdrawal itself might trigger additional financial obligations. See *Gray,* 467 U.S., at 732, 104

S.Ct., at 2719. "Those who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end." *FHA v. The Darlington, Inc.,* 358 U.S. 84, 91, 79 S.Ct. 141, 146, 3 L.Ed.2d 132 (1958). See also *Usery v. Turner Elkhorn Mining Co.,* 428 U.S., at 15-16, 96 S.Ct., at 2892-93 and cases cited therein.

The purpose of forbidding uncompensated takings of private property for public use is "to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States,* 364 U.S. 40, 49, 80 S.Ct. 1563, 1569, 4 L.Ed.2d 1554 (1960). We are far from persuaded that fairness and justice require the public, rather than the withdrawing employers and other parties to pension plan agreements, to shoulder the responsibility for rescuing plans that are in financial trouble. The employers in the present litigation voluntarily negotiated and maintained a pension plan which was determined to be within the strictures of ERISA. We do not know, as a fact, whether this plan was underfunded, but Congress determined that unregulated withdrawals from multiemployer plans could endanger their financial vitality and deprive workers of the vested rights they were entitled to anticipate would be theirs upon retirement. For this reason, Congress ***228** imposed withdrawal liability as one part of an overall statutory scheme to safeguard the solvency of private pension plans. We see no constitutionally compelled reason to require the Treasury to assume the financial burden of attaining this goal.

The judgment of the three-judge court is

Affirmed.

****1028** Justice O'CONNOR, with whom Justice POWELL joins, concurring.

Today the Court upholds the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) against a facial challenge to their validity based on the Taking Clause of the Fifth Amendment. I join the Court's opinion and agree with its reasoning and its result, but I write separately to emphasize some of the issues the Court does *not* decide today. Specifically, the Court does not decide today, and has left open in previous cases, whether the imposition of withdrawal liability under the MPPAA and of plan termination liability under the Employee Retirement Income Security Act of 1974 (ERISA) may in some circumstances be so arbitrary and irrational as to violate the Due Process Clause of the Fifth Amendment. See *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.,* 467 U.S. 717, 728, n. 7, 104 S.Ct. 2709, 2717, n. 7, 81 L.Ed.2d 601 (1984); *Nachman Corp. v. Pension Benefit Guaranty Corporation,* 446 U.S. 359, 367-368, 100 S.Ct. 1723, 1729-30, 64 L.Ed.2d 354 (1980). The Court also has no occasion to decide whether the MPPAA may violate the Taking Clause as applied in particular cases, or whether the pension plan in this case is a defined benefit plan rather than a defined contribution plan within the meaning of ERISA.

As the Court indicates, the mere fact that "legislation requires one person to use his or her assets for the benefit of another," *ante,* at ----, will not establish either a violation of the Taking Clause or the Due Process Clause. With regard to the latter provision, it is settled that in the field of economic legislation "the burden is on one complaining of a due ***229** process violation to establish that the legislature has acted in an arbitrary and irrational way." *Usery v. Turner Elkhorn Mining Co.,* 428 U.S. 1, 15, 96 S.Ct. 2882, 2892, 49 L.Ed.2d 752 (1976). Nonetheless, the Court has never intimated that Congress possesses unlimited power to "readjus[t] rights and burdens ... [and] upse[t] otherwise settled expectations." *Turner Elkhorn, supra,* at 16, 96 S.Ct., at 2893. Our recent cases leave open the possibility that the imposition of retroactive liability on employers for the benefit of employees may be arbitrary and irrational in the absence of any connection between the employer's conduct and some detriment to the employee. See *Turner Elkhorn, supra,* at 19, 24-26, 96 S.Ct., at 2894, 2896-97; *Pension Benefit Guaranty Corporation v. R.A. Gray & Co., supra,* 467 U.S., at 733, 104 S.Ct., at 2720 (discussing *Railroad Retirement Board v. Alton R. Co.,* 295 U.S. 330, 55 S.Ct. 758, 79 L.Ed. 1468 (1935)).

Insofar as the application of the provisions of the MPPAA and of ERISA to pension benefits that accrue in the future is concerned, there can be little doubt of Congress' power to override contractual provisions limiting employer liability for unfunded benefits promised to employees under the plan. But both statutes impose liability under certain circumstances on contributing employers for unfunded benefits that accrued in the past under a pension plan whether or not the employers had agreed to ensure that benefits would be fully funded. In my view, imposition of this type of retroactive liability on employers, to be constitutional, must rest on some basis in the employer's conduct that would make it rational to treat the employees' expectations of benefits under the plan as the employer's responsibility.

In enacting ERISA, Congress distinguished between two types of employee retirement benefit plans: “defined benefit plan[s]” and “defined contribution plan[s],” also known as “individual account plan[s].” See 29 U.S.C. §§ 1002(34), (35). An employer is subject to plan termination liability under ERISA only if the employee benefit plan to which the employer has contributed is covered by ERISA's plan termination insurance program, which applies to defined benefit ***230** plans but not to defined contribution plans. 29 U.S.C. § 1321(b)(1). See *Nachman Corp. v. Pension Benefit Guaranty Corporation, supra,* 446 U.S., at 363, n. 5, 100 S.Ct., at 1727, n. 5. Congress ****1029** exempted defined contribution plans from ERISA's termination insurance program because a defined contribution plan does not specify benefits to be paid, but instead establishes an individual account for each participant to which employer contributions are made. 29 U.S.C. § 1002(34). “[U]nder such plans, by definition, there can never be an insufficiency of funds in the plan to cover promised benefits.” *Nachman Corp., supra,* at 364, n. 5, 100 S.Ct., at 1727-28, n. 5.

By contrast, whenever a plan defines the benefits payable thereunder, the possibility exists that at a given time plan assets will fall short of the present value of vested plan benefits. Congress therefore subjected defined benefit plans to ERISA's plan termination insurance program, and did so by broadly defining a defined benefit plan as “a pension plan other than an individual account plan.” 29 U.S.C. § 1002(35). We have no occasion today to decide whether this definition sweeps in all plans in which the benefits to be received by employees are fixed by the terms of the plan, even if the plan also provides that the employer's contributions shall be fixed and shall not be adjusted to whatever level would be required to provide those benefits. Indeed, this litigation began in part as a challenge by the Trustees of the Operating Engineers Pension Plan to a determination by the Pension Benefit Guaranty Corporation (hereinafter PBGC) that the Pension Plan is a defined benefit plan. See *ante,* at ----. That challenge was resolved against the Trustees and is not presented here.

ERISA's broad definition of defined benefit plan may well mean that Congress imposed contingent liability on contributing employers without regard to the extent of a particular employer's actual responsibility for the existence of a plan's promise of fixed benefits to employees and without regard to the extent to which any such promise was conditioned-and ***231** understood by employees to be conditioned-by plan provisions limiting the employer's obligations to make contributions to the plan. If so, the application of ERISA may in some circumstances raise constitutional doubts under the Taking Clause or the Due Process Clause.

The same doubts arise with respect to the imposition of withdrawal liability under the MPPAA, which is properly seen as a prophylactic extension of the liability initially imposed by ERISA. Withdrawal liability is intended to ensure that “ ‘an employer withdrawing from a multiemployer plan w[ill] ... complete funding its fair share of the plan's unfunded liabilities,’ ” *R.A. Gray & Co.,* 467 U.S., at 723, n. 3, 104 S.Ct., at 2714, n. 3 (quoting Pension Plan Termination Insurance Issues: Hearings before the Subcommittee on Oversight of the House Committee on Ways and Means, 95th Cong., 2d Sess., 23 (1978) (statement of Matthew M. Lind, Executive Director of PBGC), and thus presupposes that employers can be made liable for those unfunded liabilities in the first instance. Although the MPPAA substitutes liability to the plan for liability to PBGC, the withdrawal liability it imposes on employers who contribute to multiemployer plans reflects the same apparent determination to treat all definite benefits as promises for which the employer can be held liable that underlies termination liability under ERISA. PBGC coverage of a multiemployer plan continues to turn on whether it is a defined benefit plan, and the MPPAA defines the withdrawing employer's liability to the plan in terms of “unfunded vested benefits,” 29 U.S.C. § 1391, thereby making withdrawal liability turn on the presence of fixed benefits. The MPPAA's termination liability provisions are complex, but their overall effect is also to hold employers liable for underfunding of vested fixed benefits. See 29 U.S.C. § 1341a. Thus, it is evident that the MPPAA expands on Congress' decision in ERISA to exempt only defined contribution plans, narrowly defined, from PBGC coverage and employer liability. Whether the employer's liability is to ***232** PBGC or to the plan, the thrust of both statutes is to enforce the plan's promise of fixed benefits against the employer with respect to benefits already accrued.

The degree to which an employer can be said to be responsible for the promise of ****1030** benefits made by a plan varies dramatically across the spectrum of plans. Where a single employer has unilaterally adopted and maintained a pension plan for its employees, the employer's responsibility for the presence of a promise to pay defined benefits is direct and substantial. The employer can nominate all the plan's trustees and enjoys wide discretion in designing the plan and determining the level of benefits. Where such a plan holds out to employees a promise of definite benefits, and where employees have rendered the years of service required for benefits to accrue and vest, it seems entirely rational to hold the employer liable for any shortfall in the plan's assets, even if the plan's provisions purport to limit the employer's liability in the event of underfunding upon plan termination.

Where a pension plan is established through collective bargaining between one or more employers and a union, matters may be different. Such plans, commonly known as "Taft-Hartley" plans, were authorized by § 302(c)(5) of the Labor Management Relations Act, 1947 (LMRA), 61 Stat. 157, codified, as amended, at 29 U.S.C. § 186(c)(5). Taft-Hartley plans are the product of joint negotiation between employers and a union representing employees and are administered by trustees nominated in equal numbers by employers and the union. *Ibid.* Unlike typical defined benefit plans, which call for variable employer contributions and provide for fixed benefits, most Taft-Hartley plans "possess the characteristics of both fixed contributions and fixed benefits." J. Melone, Collectively Bargained Multi-Employer Pension Plans 20 (1963) (hereinafter Melone). As PBGC has explained:

> "Employers participating in multiemployer plans are generally required to contribute at a fixed rate, specified ***233** in the collective bargaining agreement.... Traditionally, the multiemployer plan or the bargaining agreement have limited the employer's contractual obligation to contribute at the fixed rate, whether or not the contributions were sufficient to provide the benefits established by the joint board or the collectively bargained agreement." Pension Benefit Guaranty Corporation-Multiemployer Study Required by P.L. 95-214, p. 22 (1978) (hereinafter Multiemployer Study).

See also Melone 50; Goetz, Developing Federal Labor Law of Welfare and Pension Plans, 55 Cornell L.Rev. 911, 931 (1970).

Under these hybrid Taft-Hartley plans it is the plans' trustees, not the employers and the union, who are "usually responsible for determining the types of benefits to be provided ... and the level of benefits, although in some cases these are set in the collective bargaining agreement." Multiemployer Study 22 (footnote omitted). See also GAO/HRD-85-58, Comptroller General's Report to the Congress, Effects of the Multiemployer Pension Plan Amendments Act on Plan Participants' Benefits, 37, App. I, Table 3 (June 14, 1985) (95% of 139 multiemployer plans surveyed provided that trustees set benefits) (hereinafter Report to the Congress). This delegation of responsibility to the trustees may well stem from an understanding on the part of employers and unions that under the fixed-contribution approach the plan rather than the employers would bear the risks of adverse experience and the benefits of favorable experience in the first instance. See Pension Plans Under Collective Bargaining: A Reference Guide for Trade Unions 64 (American Federation of Labor 1953). If the actuary's earnings assumptions proved too conservative, the plan would have excess assets that could be used to support an increase in benefits by the trustees, and if asset growth was lower than anticipated, benefits could be reduced. It now appears that Taft-Hartley plan employers will be liable for such experience ***234** losses in many cases, even where withdrawal occurs as a result of events over which an employer has no control, and even though experience gains can still ordinarily be used to increase benefits.

It is also noteworthy that, as this Court held in *NLRB v. Amax Coal Co.,* 453 U.S. 322, 331-332, 101 S.Ct. 2789, 2795-96, 69 L.Ed.2d 672 (1981), "the duty of the ****1031** management-appointed trustee of an employee benefit fund under § 302(c)(5) is directly antithetical to that of an agent of the appointing party." ERISA conclusively established that "an employee benefit fund trustee is a fiduciary whose duty to the trust beneficiaries must overcome any loyalty to the interest of the party that appointed him." *Id.,* at 334, 101 S.Ct., at 2796. In light of these fiduciary duties, it seems remarkable to impute responsibility to employers for the level of benefits promised by the plan and set by the joint board of trustees, notwithstanding the express limits on employer liability contained in the plan and agreed to in collective bargaining.

Yet that would appear to be what Congress may have done to the extent a Taft-Hartley plan such as the pension plan in this case is treated as a pure defined benefit plan in which the employer promised to make contributions to the extent necessary to fund the fixed benefits provided in the plan. As Representative Erlenborn put it in the hearings on the MPPAA:

> "[W]e have taken something that neither looked like a duck, or walked like a duck, or quacked like a duck, and we passed a law [ERISA] and said, 'It is a duck.' If it is that easy, I suppose we can repeal the law of gravity and solve our energy problem. It is treating the multiemployer plans where you negotiate a *contribution* as having put a legal obligation on the employer to reach a level of *benefits* that has caused the problem." Hearings on The Multiemployer Pension Plan Amendments Act of 1979 before the Task Force on Welfare and Pension Plans of the Subcommittee on Labor-Management ***235** Relations of the House Committee on Education and Labor, 96th Cong., 391 (1980) (emphasis added).

The foregoing observations suggest to me that whatever promises a collectively bargained plan makes with respect to benefits may not always be rationally traceable to the employer's conduct and that it may sometimes be quite fictitious to speak of such plans as "promising" benefits at a specified level, since to do so ignores express and bargained-for conditions on those promises. Where the plan's fixed-contribution aspects were agreed to by employees through their exclusive bargaining representatives, and where employers had no control over the level of benefits promised, employer responsibility for the benefits specified by the plan is very much attenuated, and employee expectations that those benefits will in all events be paid, in the face of plain language to the contrary, are not easily traceable to the employer's conduct.

The possible arbitrariness of imposing termination and withdrawal liability on some employers contributing to fixed-cost Taft-Hartley plans may be heightened in particular cases. For example, an employer who agrees to participate in a multiemployer plan long after the plan's benefit structure has been determined may have had no say whatever in establishing critical features of the plan that determine the level of benefits and the value of those benefits. Similarly, if a plan had regularly undergone increases and reductions in accrued benefits prior to ERISA, any contention that employers caused employees to rely on a promise of fixed benefits might carry even less weight.

Beyond that, the withdrawal provisions of the MPPAA are structured in a manner that may lead to extremely harsh results. For example, it appears that even if the trustees raised benefits for both retired and current employees during the period immediately prior to an employer's withdrawal, the withdrawing employer can be held liable for the resulting underfunding. Such benefit increases are not uncommon. ***236** See Report to the Congress 43, App. I, Table 17 (68% of multiemployer plans surveyed increased benefits for working participants during 33 months prior to enactment of the MPPAA); Table 18 (46% of these plans increased retirees' benefits during the same period). In addition, the presumptive method for calculating employer withdrawal liability is based on the employer's proportionate share of the *contributions* made to the plan during the years in which the employer participated. 29 U.S.C. § 1391(b). As a result, because fixed-contribution ****1032** plans typically do not set each employer's contributions on the basis of the value of the benefits accrued by that employer's employees, it seems entirely possible that an employer may be liable to the plan for substantial sums even though that employer's contributions plus its allocable share of plan earnings *exceed* the present value of all benefits accrued by its employees.

To be sure, the Court does not address these questions today. Since this case involves only a facial challenge under the Taking Clause to the MPPAA's withdrawal liability provisions, the Court properly refuses to look into the possibility that harsh results such as those I have noted may affect its analysis, let alone a due process inquiry, when the MPPAA is applied in particular cases. I write only to emphasize some of the issues the Court does not decide today, and to express the view that termination liability under ERISA, and withdrawal liability under the MPPAA, impose substantial retroactive burdens on employers in a manner that may drastically disrupt longstanding expectations, and do so on the basis of a questionable rationale that remains open to review in appropriate cases.

All Citations

475 U.S. 211, 106 S.Ct. 1018, 89 L.Ed.2d 166, 54 USLW 4208, 7 Employee Benefits Cas. 1001

Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

[1] The inadequacy of existing law was demonstrated by the Report's finding that roughly 10% of all multiemployer plans, covering 1.3 million participants, were experiencing financial difficulties. PBGC Report, at 1. Funding of all plan benefits under these plans, if they terminated, would cost the insurance system approximately $4.8 billion and necessitate an increase in premiums to unacceptable levels. *Id.,* at 2, 16, 139. See also Hearings on the Multiemployer Pension Plan Amendments Act of 1979 before the Task Force on Welfare and Pension Plans of the Subcommittee on Labor-Management Relations of the House Committee on Education and Labor, 96th Cong., 1st Sess. 1156, 1170, 1291 (1980). See also Brief for National Coordinating Committee for Multiemployer Plans as *Amicus Curiae* 12-14; Brief for Trustees of United Mine Workers of America 1950 and 1974 Pension Plans as *Amici Curiae* 7.

[2] Article II, § 7, of the Trust Agreement provides as follows:

> "Neither the Employers nor any Signatory Association, or officer, agent, employee or committee member of the Employers or any Signatory Association, shall be liable to make Contributions to the Fund or with respect to the Pension Plan, except to the extent that he or it may be an Individual Employer required to make Contributions to the Fund with respect to his or its own individual or joint venture operations, or to the extent he or it may incur liability as a Trustee as hereinafter provided. Except as provided in Article III hereof, the liability of any Individual Employer to the Fund, or with respect to the Pension Plan, shall be limited to the payments required by the Collective Bargaining Agreements with respect to his or its individual or joint venture operations, and in no event shall he or it be liable or responsible for any portion of the Contributions due from other Individual Employers or with respect to the operations of such Individual Employers. The Individual Employers shall not be required to make any further payments or Contributions to the cost of operations of the Fund or of the Pension Plan, except as may be hereinafter provided in the Collective Bargaining Agreements." App. 30-31.

[3] Article VII, § 4, of the Plan provides as follows:

> "This Pension Plan has been adopted on the basis of an actuarial calculation which has established, to the extent possible, that the contributions will, if continued, be sufficient to maintain the Plan on a permanent basis. However, it is recognized that the benefits provided by this Pension Plan can be paid only to the extent that the Plan has available adequate resources for those payments. No Individual Employer has any liability, directly or indirectly to provide the benefits established by this Plan beyond the obligation of the Individual Employer to make contributions as stipulated in any Collective Bargaining Agreement. In the event that at any time the Pension Fund does not have sufficient assets to permit continued payments under this Pension Plan, nothing contained in this Pension Plan and the Trust Agreement shall be construed as obliging any Individual Employer to make benefit payments or contributions (other than the contributions for which the Individual Employer may be obliged by any Collective Bargaining Agreement) in order to provide for the benefits established by the Pension Plan. Likewise, there shall be no liability upon the Board of Trustees, individually or collectively, or upon the Employers, Signatory Association, Individual Employer, or Union to provide the benefits established by this Plan if the Pension Fund does not have the assets to make such benefit payments." *Id.,* at 31-32.

[4] Title 29 U.S.C. § 1002(34) describes a "defined contribution plan" as "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and forfeitures of accounts of other participants which may be allocated to such participant's account." The Plan Termination Insurance provisions of ERISA do not apply to such plans. § 1321(b)(1).

[5] Penfield & Smith, Inc., Roy L. Klema Engineers, Inc., and Municipal Engineers, Inc., also intervened in the proceedings before the District Court. These employers are not parties to this appeal, however, as the Trustees have determined that they have incurred no liability under the Act. Brief for Appellant in No. 84-1567, p. ii.

[6] The three-judge court also rejected appellants' arguments that the MPPAA violated due process, the Contract Clause, and several other constitutional provisions. See App. to Juris. Statement in No. 84-1555, pp. 8-14.

The panel's decision upholding the constitutionality of the MPPAA is consistent with the result reached by every other court to have considered the issue. *Keith Fulton & Sons, Inc. v. New England Teamsters and Trucking Industry Pension Fund,* 762 F.2d 1124 (CA1 1984), modified on other grounds, 762 F.2d 1137 (1985); *Board of Trustees of Western Conference of Teamsters Pension Trust Fund v. Thompson Building Materials, Inc.,* 749 F.2d 1396 (CA9 1984), cert. denied, 471 U.S. 1054, 105 S.Ct. 2116, 85 L.Ed.2d 481 (1985); *Terson Co. v. Bakery Drivers and Salesmen Local 194,* 739 F.2d 118 (CA3 1984); *Washington Star Co. v. International Typographical Union Negotiated Pension Plan,* 235 U.S.App.D.C. 1, 729 F.2d 1502 (1984); *Textile Workers Pension Fund v. Standard Dye & Finishing Co.,* 725 F.2d 843 (CA2), cert. denied *sub nom. Sibley, Lindsay & Curr Co. v. Bakery Workers,* 467 U.S. 1259, 104 S.Ct. 3554, 82 L.Ed.2d 856 (1984); *Peick v. Pension Benefit Guaranty Corporation,* 724 F.2d 1247 (CA7 1983), cert. denied, 467 U.S. 1259, 104 S.Ct. 3554, 82 L.Ed.2d 855 (1984); *Republic Industries, Inc. v. Teamsters Joint Council No. 83 of Virginia Pension Fund,* 718 F.2d 628 (CA4 1983), cert. denied, 467 U.S. 1259 (1984); *Dorn's Transportation, Inc. v. I.A.M. National Pension Fund Benefit Plan,* 578 F.Supp. 1222 (DC 1984), aff'd 243 U.S.App.D.C. 348, 753 F.2d 166 (1985); *Speckmann v. Paddock Chrysler Plymouth, Inc.,* 565 F.Supp. 469 (ED Mo.1983). In *Keith Fulton, Thompson Building Materials, Terson, Peick, Republic Industries, Dorn,* and *Speckmann,* the Taking Clause claim was directly at issue.

7 Appellant Trustees make two additional arguments as well. First, they argue that if the imposition of withdrawal liability is invalid under the Taking Clause, then the related provisions of the MPPAA requiring multiemployer plans to pay premiums to the PBGC are also invalid, as they are inseverable from the overall statutory scheme. Second, the Trustees contend that the statutory provisions requiring multiemployer plans to pay premiums to the PBGC and authorizing the PBGC to use the funds "in its discretion" to pay benefits to participants of a terminated multiemployer plan violate the principle of separation of powers by delegating legislative authority to the PBGC.

Because we find that the withdrawal liability provisions of the Act are valid under the Taking Clause, we need not address the Trustees' first assertion. As to the Trustees' separation-of-powers contention, we find little merit in this argument. Title 29 U.S.C. § 1381(c)(2)(B) (1976 ed.) stated that the PBGC was to pay benefits if it determined "that the payment ... of benefits guaranteed under [ERISA] with respect to that plan [would] not jeopardize the payments the [PBGC] anticipate[d] it may be required to make in connection with [the mandatory guarantee program]." Congress delegated discretionary, rather than mandatory, coverage for multiemployer plans prior to 1980 because it needed "time for thorough consideration of the complex issues posed by the termination of multiemployer pension plans." *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.,* 467 U.S. 717, 721, n. 1, 104 S.Ct. 2709, 2714, n. 1, 81 L.Ed.2d 601 (1984). In these circumstances, the delegation of discretionary authority was a reasonable means of achieving congressional aims, and we are not persuaded that Congress failed to provide a clear "intelligible principle" to guide the PBGC in the exercise of this authority under the Act. See *J.W. Hampton, Jr., & Co. v. United States,* 276 U.S. 394, 409, 48 S.Ct. 348, 352, 72 L.Ed. 624 (1928).

8 Several sections of the Act moderate the impact of a withdrawing employer's liability by exempting certain transactions from being characterized as "withdrawals." See, *e.g.,* 29 U.S.C. §§ 1383(b), (c) (applying special definitions for determining whether there has been a complete or partial withdrawal from a pension plan in the building and construction industry and in the entertainment industry); § 1384 (cessation or reduction of contribution obligations as a result of an employer's sale of its assets does not result in a withdrawal, provided certain other conditions are met); § 1398(1) (change of corporate structure where successor continues to contribute to plan is not a withdrawal); § 1398(2) (withdrawal does not occur where employer suspends contributions to plan during labor dispute involving its employees).

Other sections reduce the size of the financial liability in various instances. See, *e.g.,* 29 U.S.C. § 1389(a) (creating a *de minimis* rule which eliminates withdrawal liability entirely for an employer whose obligation would be equal to or less than the smaller of (1) ¾ of 1% of the plan's unfunded vested obligations; or (2) $50,000; § 1405(a)(1) (limiting withdrawal liability for employer who liquidates his business); § 1390(a)(2) (establishing a "free look" provision, whereby new employers may withdraw without liability if they had an obligation to contribute for no more than six consecutive plan years, or, if shorter, the number of years required for vesting under the plan).

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TAB 72

2016 WL 7077109
Only the Westlaw citation is currently available.
United States District Court,
S.D. New York.

Elsevier, Inc., et al., Plaintiff,
v.
Pierre Grossman, et al., Defendants.

12 Civ. 5121 (KPF)
|
Signed August 4, 2016

Synopsis

Background: Publishers of scientific, technical, and medical journals brought action alleging that Brazilian subscription agency and its president obtained multiple journal subscriptions at discounted rates and then resold the journals to institutions that were ineligible for the discounts, asserting claims under Racketeer Influenced and Corrupt Organizations Act (RICO) and for conversion and breach of contract. Following entry of default judgment against subscription agency and jury verdict finding that president had violated RICO, breached one or more contracts, and had converted publishers' property, president moved for judgment as a matter of law on the RICO claim and publishers moved for judgment as a matter of law on the question of RICO damages, or, in the alternative, for a new trial solely on question of RICO damages.

Holdings: The District Court, Katherine Polk Failla, J., held that:

[1] president of agency was natural person distinct from RICO enterprise;

[2] president of agency committed domestic conduct relevant to focus of mail fraud statute;

[3] competitive injury suffered by publishers was not domestic injury;

[4] publishers did not prove domestic injury based on parting with property under false pretences;

[5] publishers were not entitled to amend pleadings to allege domestic injury; and

[6] jury's answers on verdict form could be reconciled.

Motion granted in part; denied in part.

Attorneys and Law Firms

Jason Lee Jurkevich, Sills Cummis & Gross, New York, NY, for Plaintiff.

Pierre Grossman, Garden City, NY, pro se.

OPINION AND ORDER

KATHERINE POLK FAILLA, District Judge:

*1 Plaintiffs Elsevier Inc., Elsevier B.V., Elsevier Ltd., and Elsevier Masson SAS (collectively, "Plaintiffs" or "Elsevier") publish scientific, technical, and medical journals. On June 29, 2012, Plaintiffs initiated this action against Defendants Publicações Técnicas Internacionais ("PTI"), IBIS Corp. ("IBIS"), and Pierre Grossman ("Grossman" and, together with PTI and IBIS, "Defendants"), alleging that Defendants had obtained multiple journal subscriptions at discounted rates, and then resold the journals to institutions that were ineligible for the discounts. On May 8, 2015, the Court entered default judgment against PTI and IBIS, but Grossman proceeded to trial. On January 14, 2016, a jury determined that Grossman had violated the Racketeer Influenced and Corrupt Organizations Act ("RICO" or the "Act"), 18 U.S.C. §§ 1961–68, but that he had not engaged in a conspiracy to violate the Act. The jury further determined that Grossman had breached one or more contracts with Plaintiffs and that he had converted Plaintiffs' property. The jury awarded Plaintiffs $11,108 in damages for the RICO violation and $6,201 for the contractual breaches, but found that Plaintiffs had not been damaged by the conversion of their property.

On February 15, 2016, Grossman filed a motion for judgment as a matter of law on the RICO claim (the "RICO Motion"). The following day, Plaintiffs filed: (i) a motion for judgment as a matter of law on the question of RICO damages, or in the alternative, for a new trial solely on the question of RICO damages (the "Damages Motion"); (ii) a motion for an award of damages and an entry of final default judgment against PTI and IBIS (the "Motion for Final Default Judgment"); and (iii) a motion for attorneys' fees and costs under 18 U.S.C. § 1964(c) (the "Fee Motion"). For the reasons set forth herein, the RICO Motion is granted, but Plaintiffs may request a new trial at which they might be able to establish RICO liability against Grossman; the Damages Motion is denied; the Motion for Final Default Judgment is granted in part and denied in part; and the Fee Motion is denied.

BACKGROUND[1]

*2 The Court assumes familiarity with the facts and procedural history set forth in its prior decision denying Plaintiffs' motion for default judgment and granting Plaintiffs leave to amend the Complaint, *Elsevier, Inc. v. Grossman*, No. 12 Civ. 5121 (KPF), 2013 WL 6331839 (S.D.N.Y. Dec. 5, 2013) ("*Elsevier I* "), as well as the Court's opinion granting in part Defendants' motion to dismiss, *Elsevier, Inc. v. Grossman*, 77 F.Supp.3d 331 (S.D.N.Y. 2015) ("*Elsevier II* "). For convenience, the facts relevant to this Opinion are set forth below.

A. Factual Background

1. Plaintiffs' Business

Plaintiffs are a group of related publishing companies with offices in Amsterdam, Paris, London, and New York. (*See* Tr. 149). Together, Plaintiffs produce approximately 2,000 scientific and technological journals, which are geared toward "specialists and professionals" in various fields of medicine, science, and engineering. (*See id.* at 149–50). Plaintiffs incur substantial costs to create these journals, including the costs of soliciting articles; reviewing the articles; and printing and distributing the journals to customers. (*Id.* at 150–51).

Plaintiffs sell their journals through annual subscriptions, either directly or through subscription agents. (Tr. 151, 154). Subscription agents help customers complete the paperwork required to obtain subscriptions for various journals. (*See id.* at 154).

Plaintiffs charge two different prices for their products: Institutions (such as universities and libraries) pay full price, because Plaintiffs expect that institutions will make their journals available to multiple readers. (Tr. 151–52). By contrast, if an individual wishes to purchase a journal for his or her own personal use, he or she can order the journal at a discounted rate. (*Id.*). Plaintiffs do not earn a profit on the subscriptions sold to individuals at the discounted price. (*Id.* at 152–53). As a result, when a subscription agent buys a journal for an individual reader, or when an individual buys a journal directly from Plaintiffs, the agent or the individual must sign a contract stating that the journal has been ordered for "valid personal use." (*See, e.g.*, Ex. 11; *see also* Tr. 154–55). In other words, the agent or the individual must promise that the journal will not be given to an institution that should have paid full price. (*Id.* at 154–55).

2. Defendants' Business

Pierre Grossman is a citizen and resident of Brazil. He is also the president and founder of PTI—a Brazilian subscription agency. (Tr. 341, 344, 348–49). Since 2000, Grossman and his wife have been PTI's sole shareholders. (*Id.* at 341). PTI has a handful of employees, including Grossman's brother-in-law, Roberto Saad. (*Id.* at 343, 345).

As the president of PTI, Grossman ordered thousands of journal subscriptions for Brazilian institutions and individuals from publishers located "all over the world." (*See* Tr. 348). However, he found that Brazilian regulations made it very difficult for PTI to pay these publishers. (*Id.* at 346). As Grossman testified at trial, the Brazilian Central Bank charges a flat fee for any check sent from Brazil to a foreign country. (*Id.* at 348). Thus, if PTI sent multiple checks to foreign publishers, it would have to pay a fee for each check. (*Id.*). In order to reduce PTI's banking fees, Grossman established a New York corporation called IBIS. (*Id.* at 345, 348–49). Each month, Grossman would send one large check from PTI's account in Brazil to IBIS's account in New York, and the Brazilian Central Bank would charge him only one fee. (*See id.* at 348–49). Once the money arrived in IBIS's account, Grossman would use it to pay various publishers, including Plaintiffs. (*See id.*).

*3 Grossman also testified that around the year 2000, he and his family purchased a small apartment in Garden City, New York. (Tr. 342). This apartment served as an "office" and mailing address for IBIS. (*Id.* at 341–42). Occasionally, Grossman asked publishers to ship journals to the apartment because "the Post office didn't work in Brazil for delivery." (*Id.* at 348, 350).

3. Defendants' Subscription Fraud

Between 2007 and 2011, Defendants ordered 51 journal subscriptions from Plaintiffs at the discounted rate applicable to individual readers. (Ex. 10). Nevertheless, over the course of the trial, Plaintiffs proved conclusively that Defendants acquired the 51 subscriptions for Brazilian institutions, which were ineligible for the discount. (*Id.*).

B. Procedural Background

1. The Pretrial Proceedings

Plaintiffs filed the instant action on June 29, 2012. (Dkt. # 1). However, Grossman, PTI, and IBIS missed their deadline to answer the Complaint. Consequently, on June 7, 2013, the Clerk of Court entered certificates of default against these three defendants. (Dkt. # 8–10). The Court issued an Order to Show Cause on July 30, 2013, requiring Grossman, IBIS, and PTI to show cause why a default judgment should not be entered against them. (Dkt. # 12). On August 30, 2013, the Court held a hearing at which Grossman, PTI, and IBIS were jointly represented by counsel; counsel raised several arguments opposing the entry of default judgment. (*See generally* Aug. 30 Tr.). On December 5, 2013, the Court issued an Opinion and Order vacating the certificate of default against Grossman, PTI, and IBIS, largely because Plaintiffs had not adequately pleaded their RICO claims. *See generally Elsevier I*, 2013 WL 6331839.

On February 4, 2014, Plaintiffs filed an Amended Complaint, which cured the deficiencies that the Court had identified in the original Complaint. (Dkt. # 33). On May 20, 2014, Defendants moved to dismiss the Amended Complaint for lack of subject matter jurisdiction and failure to state a claim. (Dkt. # 39). On January 5, 2015, the Court issued an Opinion and Order denying Defendants' motion in part and granting it in part. *See generally Elsevier II*, 77 F.Supp.3d 331. The Court held that it had personal jurisdiction over Defendants, and that Plaintiffs had stated valid RICO claims. *Id.* at 342–51. The Court further held that Plaintiffs had stated a valid claim for conversion under New York law. *Id.* at 352. However, the Court concluded that Plaintiffs had *not* stated a valid state-law claim for fraud. *Id.*

On January 23, 2015, Defendants' counsel moved to withdraw. (Dkt. # 47). After the Court granted counsel's motion (Dkt. # 49), Grossman decided to proceed *pro se* (*see* Dkt. # 52). Similarly, PTI and IBIS declined to retain new counsel. (Dkt. # 55). As corporate entities, however, PTI and IBIS could not take any action in this case without an attorney. *See Sec. & Exch. Comm'n v. Research Automation Corp.*, 521 F.2d 585, 589 (2d Cir. 1975) ("It is settled law that a corporation may not appear in a lawsuit against it except through an attorney [.]" (internal citation omitted)). Thus, PTI and IBIS defaulted. (Dkt. # 65–66).

On April 7, 2015, this Court issued a second Order to Show Cause why default judgment should not be entered against the two corporate Defendants. (Dkt. # 70). Following a hearing on May 8, 2015, the Court "ordered, adjudged[,] and decreed that Plaintiffs ha[d] judgment against [D]efendants IBIS and PTI as to liability on those claims in Plaintiffs' Amended Complaint remaining after the Court's January 5, 2015 Opinion and Order." (Dkt. # 80 (capitalization omitted)). But the Court deferred an inquest on damages until after it had reached "a disposition of the claims against [D]efendant Pierre Grossman." (*Id.*).

2. The Trial

*4 Trial against Defendant Grossman began on January 11, 2016, and lasted four days. (*See* Dkt. # 196–203). Over the course of these proceedings, Plaintiffs presented testimony from multiple witnesses. (Tr. 148–394). Rayan Guman, an employee of Elsevier BV, testified about Elsevier's business model and the steps that Elsevier takes to discover and combat subscription fraud. (Tr. 148–254).

In addition, Andrew Pitts, an employee of Publisher Solutions International ("PSI"), testified that Plaintiffs submit data about their customers to PSI, and PSI analyzes this data to identify individuals who may be ordering subscriptions at an individual rate, and then reselling those subscriptions to institutions. (Tr. 285–313). Pitts also explained how he discovered Defendants fraudulent conduct. (*Id.*). Pitts testified that, with the help of an algorithm, he was able to identify several suspicious subscriptions ordered by Defendants. (*Id.*). For example, he identified a large number of subscriptions —for journals that spanned a variety of disciplines—that were ordered on behalf of one individual. (*See id.* at 304–05, Ex. 51). Because it is very unlikely that an individual reader would order such a broad array of journals for his own personal use, these subscriptions raised a "red flag." (Tr. 305). Similarly, Pitts testified that he was surprised to see multiple PTI subscriptions—purportedly ordered on behalf of a variety of individuals with different names—shipped to a single address. (*Id.*). In Pitts's words: "[I]f you are receiving to one address subscriptions for a whole multitude of names, you've either got a very, very full house, or you're receiving things for other people. Again, ... it's a red flag." (*Id.*).

Plaintiffs also called Grossman as a witness to explain his subscription business and the orders that he had placed on behalf of PTI's customers. (Tr. 340–88). Finally, Plaintiffs introduced a wide variety of business records, including order forms, invoices, and receipts—from themselves and PTI—suggesting that Defendants were purchasing subscriptions on behalf of individuals, and then reselling them to institutions. (*See* Pl. Damages Br. 5–8 (listing the documents used to demonstrate subscription fraud)).

After Plaintiffs presented their case, the Court "deem[ed] [Grossman] to have made a motion for judgment in [his] favor as a matter of law on any grounds that were available to [him] ... at [that] time." (Tr. 395). Then, Plaintiffs' counsel proceeded to explain why he believed that Plaintiffs had presented adequate evidence to support their substantive RICO claim, RICO conspiracy claim, breach-of-contract claim, and conversion claim. (*Id.* at 395–401). Ultimately, the Court "reserve[d] on the motion" for judgment as a matter of law. (*Id.* at 401).

Grossman testified on his own behalf, and claimed that Defendants were falsely accusing him of subscription fraud to run him out of business. (Tr. 388–94). He did not present any other evidence to the jury.

After five hours of deliberations, the jury determined that Grossman had violated RICO, but had not conspired to violate the Act. (Dkt. # 167). The jury also determined that Grossman had breached one or more contracts with Plaintiffs and converted Plaintiffs' property. (*Id.*). The jury awarded $11,108 in damages for the RICO violation and $6,201 for the contractual breaches, but did not award any damages on the conversion claims. (*Id.*).

3. The Motion for a Preliminary Injunction and Writ of Attachment

*5 On December 28, 2015, less than a month before trial was set to begin, Plaintiffs moved for a temporary restraining order or, in the alternative, for a writ of pre-judgment attachment. (Dkt. # 155). Plaintiffs sought this relief to restrain newly-discovered funds in an account belonging to IBIS, which funds could be used to satisfy any judgment against Defendants in this case. (Dkt. # 156). As is relevant here, Plaintiffs explained that they were entitled to restrain the funds because, under some circumstances, New York law allows a plaintiff to restrain the funds of a foreign defendant, and the funds in the IBIS account belonged to PTI—a foreign corporation. (*Id.* at 6–7). More specifically, Plaintiffs argued:

> [E]ven though the ... account is held in the name of IBIS, as Mr. Grossman testified at his deposition and has repeated in correspondence, the funds in that account belong to PTI.... The very purpose of IBIS's existence is for PTI to be able to process international payments to ... publishers, while minimizing transactional fees that would otherwise be required every time PTI wanted to transfer money from Brazil.... Thus, in a real sense, the funds currently in the IBIS account are PTI's funds, which are deposited into IBIS's account solely for the purpose of paying for subscriptions placed by PTI and furthering PTI's business.

(*Id.* at 7). On December 30, 2015, the Court held a telephone conference to discuss Plaintiffs' application, and then requested additional written submissions from the parties. (*See* Dkt. # 165). Plaintiffs submitted additional materials to the Court on January 4, 2016. (Dkt. # 161). The Court held further oral arguments on Plaintiffs' application on January 11, 2016. (Dkt. # 196). During these arguments, the Court asked the parties to confirm that IBIS is merely an alter ego of PTI. (*Id.* at 23–24). In response to questions from the Court, Grossman confirmed that: (i) IBIS has no employees; and (ii) IBIS has "no operations" and exists "only as a pass[-]through" for money sent from PTI to non-Brazilian publishers. (*Id.* at 26).

On January 15, 2016, the Court denied Plaintiffs' request for a temporary restraining order or writ of attachment without prejudice, and stated that Plaintiffs could "renew their application for either form of relief if they present[ed] additional information suggesting that an order of attachment [was] necessary to protect their rights." (Dkt. # 168). On January 27, 2016, after the trial against Grossman had concluded, Plaintiffs filed a renewed application for a preliminary injunction or writ of attachment restraining the funds in the IBIS account; this application contained a more robust explanation of Plaintiffs' concerns that the funds might disappear in the absence of court intervention. (Dkt. # 174). In their renewed application, Plaintiffs reiterated their belief that IBIS's "sole function" is to serve as "a pass-through for payments from PTI to publishers." (Dkt. # 175 at 2). On January 29, 2016, the Court granted Plaintiffs' request for a preliminary injunction, and restrained $300,000 in the IBIS account. (Dkt. # 180).[2]

4. The Post–Trial Motions

The parties filed their post-trial motions on February 15 and 16, 2016 (Dkt. # 185, 187, 189, 192), and they filed their opposition papers on March 15, 2016 (Dkt. # 204–05). Finally, they filed their reply on March 29, 2016. (Dkt. # 206, 208).[3]

*6 On June 24, 2016, the Court issued an order requesting supplemental briefing from the parties regarding: (i) the Supreme Court's June 20, 2016 decision in *RJR Nabisco, Inc. v. European Cmty.*, ––– U.S. ––––, 136 S.Ct. 2090, 195 L.Ed.2d 476 (2016); and (ii) potential inconsistency in the jury's verdicts. (Dkt. # 211). Both parties submitted their supplemental briefs on July 15, 2016. (Dkt. # 219–20).

DISCUSSION

A. Applicable Law

1. Motions Under Federal Rule of Civil Procedure 50

[1] [2] Under Federal Rule of Civil Procedure 50, a litigant may move for judgment "as a matter of law" after a trial. Rule 50 "imposes a heavy burden on [the] movant, who will be awarded judgment as a matter of law only when a party has been fully heard on an issue during a jury trial and the court finds that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party on that issue." *Cash v. County of Erie,* 654 F.3d 324, 333 (2d Cir. 2011) (internal quotation marks omitted); *accord Bucalo v. Shelter Island Union Free Sch. Dist.*, 691 F.3d 119, 127–28 (2d Cir. 2012). The "burden is particularly heavy where, as here, the jury has deliberated in the case and actually returned its verdict in favor of the non-movant." *Cash*, 654 F.3d at 333 (internal quotation marks omitted). In such circumstances, a court may set aside the verdict only if, viewing the evidence in the light most favorable to the non-movant, "there exists such a complete absence of evidence supporting the verdict that the jury's findings could only have been the result of sheer surmise and conjecture, or the evidence in favor of the movant is so overwhelming that reasonable and fair minded persons could not arrive at a verdict against it." *Id.* (internal quotation marks omitted); *accord Stampf v. Long Island R.R. Co.*, 761 F.3d 192, 197–98 (2d Cir. 2014); *see also, e.g., Zellner v. Summerlin*, 494 F.3d 344, 371 (2d Cir. 2007) (stating that a Rule 50 motion may be granted only if the court concludes that "a reasonable juror would have been compelled to accept the view of the moving party" (internal quotation marks omitted)).

2. RICO

[3] Congress enacted RICO to combat "racketeering activity." See *RJR Nabisco*, 136 S.Ct. at 2096–97. "Racketeering activity" occurs when an individual commits two or more predicate offenses within a ten-year period, *see* 18 U.S.C. § 1961(5); those predicate offenses are related to one another, *see H.J. Inc. v. Nw. Bell Tel. Co.*, 492 U.S. 229, 239, 109 S.Ct. 2893, 106 L.Ed.2d 195 (1989); and the predicates "amount to or pose a threat of continued criminal activity," *id.*

The heart of RICO is 18 U.S.C. § 1962, which creates four substantive prohibitions against "racketeering activity." This case concerns the third and fourth prohibitions. The third prohibition reads:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

18 U.S.C. § 1962(c). The fourth prohibition makes it unlawful for anyone to conspire to violate any part of § 1962. 18 U.S.C. § 1962(d).

While RICO establishes criminal penalties for violations of § 1962, *see* 18 U.S.C. § 1963, it also creates a private right of action for individuals who are harmed by racketeering activity, *see* 18 U.S.C. § 1964. Section 1964 provides, in relevant part, that "[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee[.]" 18 U.S.C. § 1964(c).

B. Analysis

1. The Court Grants Grossman's RICO Motion

*7 Grossman argues that he is entitled to judgment as a matter of law for two reasons: (i) Plaintiffs failed to prove the existence of a RICO enterprise that was distinct from Grossman; and (ii) holding Grossman liable under federal law would involve an impermissible extraterritorial application of the RICO statutes. The Court will address each of these arguments in turn.

a. Plaintiffs Proved the Existence of a RICO Enterprise That Was Distinct from Grossman

[4] [5] RICO provides that it is unlawful for a "person" who is "employed by or associated with" an "enterprise" to conduct the enterprise's affairs through a pattern of racketeering activity. 18 U.S.C. § 1962(c). Thus, to recover damages under 18 U.S.C. § 1964, a plaintiff must "prove the existence of two distinct entities: [i] a 'person'; and [ii] an 'enterprise' that is not simply the same 'person' referred to by a different name." *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 161, 121 S.Ct. 2087, 150 L.Ed.2d 198 (2001); *accord First Capital Asset Mgmt., Inc. v. Satinwood, Inc.*, 385 F.3d 159, 173 (2d Cir. 2004). According to Grossman, a plaintiff cannot satisfy this distinctiveness requirement by alleging that corporate employees are "persons" who operate a corporate "enterprise." (*See* Def. RICO Br. 3–5; Def. RICO Reply 3–5). After all, when corporate employees take action within the scope of their employment, those actions are not generally regarded as the actions of discrete individuals; rather, they are regarded as the actions of a single corporate person. (*See* Def. RICO Br. 3–5 (citing *Riverwoods Chappaqua Corp. v. Marine Midland Bank, N.A.*, 30 F.3d 339, 344 (2d Cir. 1994)); Def. RICO Reply 3–5). This single corporate person can only be held liable for participating in a criminal "enterprise" if it associates with *another* individual or organization. (*See id.*).

Applying these principles, Grossman contends that Plaintiffs have failed to satisfy RICO's distinctiveness requirement. (*See* Def. RICO Br. 3–5; Def. RICO Reply 3–5). Over the course of the trial, Plaintiffs argued that Grossman participated in a RICO enterprise consisting of PTI, IBIS, Roberto Saad, and Grossman himself. (*See* Tr. 424–25, 464). However, Plaintiffs also maintained that PTI and IBIS were alter egos. (Dkt. # 208 Def. RICO Reply 1–5). Thus, Grossman argues, the alleged enterprise in this case consists of a single corporation—known to some entities as PTI and other entities as IBIS—as well as two of the corporation's employees, with no proof that PTI and IBIS were associated with some other individual or organization. (*See* Def. RICO Br. 3–5; Def. RICO Reply 3–5). In other words, Plaintiffs never proved that Defendants participated in a RICO enterprise distinct from themselves. (*See id.*).

This line of reasoning is squarely foreclosed by the Supreme Court's decision in *Cedric Kushner*. In that case, the Supreme Court considered whether a plaintiff could satisfy RICO's distinctiveness requirement by proving that an officer of a corporation was "employed by or associated with" the corporation, and that the officer "conduct[ed] the corporation's affairs in a RICO-forbidden way." 533 U.S. at 161–63, 121 S.Ct. 2087. Ultimately, the Court concluded that the answer to this question is yes. *See id.* at 163, 121 S.Ct. 2087. As the Court explained, a corporate officer is a "natural person[ ] ... distinct from the corporation itself, a legally different entity with different rights and responsibilities due to its different legal status." *Id.* And nothing in RICO requires more distinctiveness than that. *Id.* Here, Plaintiffs have proved that Grossman, a natural person, conducted the affairs of PTI and IBIS in a RICO-forbidden way. Under *Cedric Kushner*, this proof is sufficient to support the jury's conclusion that Grossman violated RICO.

*8 Grossman contends that *Cedric Kushner* is inapposite because, in that case, the "person" who allegedly violated RICO was the sole officer (and sole employee) of a closely held corporation, and the RICO enterprise was the corporation itself. (Def. RICO Reply 3 (citing *Cedric Kushner*, 533 U.S. at 164, 121 S.Ct. 2087)). However, the Supreme Court was careful to distinguish cases like *Riverwoods*, where the "person" charged with violating RICO was a corporation, and the alleged enterprise consists of the "corporation, together with all its employees and agents." *Cedric Kushner*, 533 U.S. at 164, 121 S.Ct. 2087 (citing *Riverwoods*, 30 F.3d at 344). As the Supreme Court explained, "[i]t is natural to speak of a corporate employee as a 'person employed by' the corporation." *Id.* (quoting § 1962(c)). But it is "less natural" to speak of a corporation as a person "employed by" or "associated with" itself and its agents. *Id.* Thus, the Court refused to overturn *Riverwoods*' holding that a corporate "person" cannot be held liable for violating RICO if the alleged "enterprise" consists solely of the corporation and its employees. *Id.* (citing *Riverwoods*, 30 F.3d at 344). In this case, Grossman insists, there is only one "person" responsible for committing RICO predicates—the corporate person known as PTI or IBIS. (Def. RICO Reply 3). And under *Riverwoods*, this "person" is insufficiently distinct from the alleged RICO "enterprise," which consists of the corporate person and two of its employees (Grossman and Saad). (*Id.* (citing *Riverwoods*, 30 F.3d at 344)).

[6] This argument misses the mark. *Cedric Kushner* asks courts to consider the nature of the "person" who is accused of violating RICO. If a "natural person" is accused of violating the statute, that "person" is distinct from any corporate "enterprise" because: (i) as a natural person, his legal rights and responsibilities are different from those of the corporation; and (ii) from a grammatical perspective, it makes sense to say that a natural person associates with or is employed by a corporation. For precisely the same reasons, a natural person is distinct from an enterprise consisting of a corporation and its employees. By contrast, a corporate person may not be distinct from an enterprise consisting of the corporation and its employees because: (i) the corporation may have the same legal rights and responsibilities as such an enterprise; and (ii) as explained above, it makes little grammatical sense to say that a corporation associates with itself and its agents.

Here, there is no dispute that Grossman is a natural person. Thus, under *Cedric Kushner*, there can be no dispute that Grossman is distinct from an enterprise consisting of PTI/IBIS and its employees. Grossman cannot escape this conclusion by arguing that PTI/IBIS also happened to be accused of violating RICO, and PTI/IBIS may be an improper defendant under *Riverwoods*. Even if PTI/IBIS were an improper defendant, that would not change the fact that Plaintiffs raised a proper RICO claim against Grossman.

b. Holding Grossman Liable Under Federal Law Would Involve an Impermissible Extraterritorial Application of RICO

Alternatively, Grossman contends that holding him liable under federal law would involve an impermissible extraterritorial application of RICO. (*See* Def. RICO Br. 5–6; Def. RICO Reply 5–6; Def. Supp. Br. 2–4). While the Court cannot accept all of Grossman's arguments on this front, it agrees with his ultimate conclusion.

i. Extraterritoriality in General

[7] "It is a basic premise of our legal system that, in general, 'United States law governs domestically but does not rule the world.' " *RJR Nabisco*, 136 S.Ct. at 2100 (quoting *Microsoft Corp. v. AT & T Corp.*, 550 U.S. 437, 454, 127 S.Ct. 1746, 167 L.Ed.2d 737 (2007)). Thus, when courts interpret federal statutes, they must presume that those statutes only apply within U.S. borders; this presumption can only be rebutted by an "affirmative[ ] and unmistakabl[e]" instruction from Congress that the statute applies extraterritorially. *Id.* (citing *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 255, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010)). This rule of statutory construction ensures that Congress—rather than the judiciary—is the entity navigating the "delicate field of international relations." *Kiobel v. Royal Dutch Petroleum Co.*, ––– U.S. ––––, 133 S.Ct. 1659, 1664, 185 L.Ed.2d 671 (2013).

[8] To determine whether the presumption against extraterritoriality limits the reach of a statutory provision in a particular case, a court must employ a two-step procedure. At the first step, the Court asks "whether the presumption against extraterritoriality has been rebutted—that is, whether the statute gives a clear, affirmative indication that it applies extraterritorially." *RJR Nabisco*, 136 S.Ct. at 2101. The court "must ask this question regardless of whether the statute in question regulates conduct, affords relief, or merely confers jurisdiction." *Id.* If the statute applies extraterritorially, then the Court's inquiry is at its end. *See id.*

*9 [9] However, if there is nothing in the statute to rebut the presumption against extraterritoriality, the court must proceed to the second step of the analysis, which requires the court to consider whether the case involves a domestic or extraterritorial application of the relevant law. *RJR Nabisco*, 136 S.Ct. at 2101. A court "do[es] this by looking to the statute's 'focus' ":

> If the conduct relevant to the statute's focus occurred in the United States, then the case involves a permissible domestic application even if other conduct occurred abroad; but if the conduct relevant to the focus occurred in a foreign country, then the case involves an impermissible extraterritorial application regardless of any other conduct that occurred in U.S. territory.

Id.; *accord In Matter of Warrant to Search a Certain E–Mail Account Controlled & Maintained by Microsoft Corp.*, 829 F.3d 197, 210–11 (2d Cir. 2016).

ii. Extraterritoriality of the RICO Statutes

In *RJR Nabisco*, the Supreme Court applied this two-step framework to determine the extent to which the "substantive prohibitions in § 1962 may apply to foreign conduct." 136 S.Ct. at 2101. At step one, the Court found that § 1962 "gives a clear, affirmative indication that [it] applies to foreign racketeering activity—but only to the extent that the predicates alleged in a particular case themselves apply extraterritorially." *Id.* at 2102. Thus, for any crime to constitute a proper predicate act under RICO, the crime must involve: (i) a violation of a statute that applies extraterritorially *or* (ii) domestic conduct that is relevant to the "focus" of a domestic criminal statute. *See id.* at 2101–02.

[10] After considering the extraterritorial reach of § 1962, the Supreme Court went on to decide whether § 1964—which creates a private right of action for "[a]ny person injured in his business or property by reason of a violation of section 1962"—also applies extraterritorially. *RJR Nabisco*, 136 S.Ct. at 2106 (quoting 18 U.S.C. § 1964). The Court explained that "we separately apply the presumption against extraterritoriality to RICO's cause of action despite our conclusion that the presumption has been overcome with respect to RICO's substantive prohibitions." *Id.* And "[n]othing in § 1964(c) provides a clear indication that Congress intended to create a private right of action for injuries suffered outside of the United States." *Id.* at 2108. Thus, the Court concluded, "[s]ection 1964(c) requires a civil RICO plaintiff to allege and prove a domestic injury to business or property and does not allow recovery for foreign injuries." *Id.* at 2111. The Court acknowledged that "the application of this rule in any given case will not always be self-evident," but declined to articulate a definition of a "domestic injury to business or property," leaving that question for another case. *Id.*

With this background in mind, the Court now turns to Grossman's specific contentions regarding extraterritoriality.

iii. It Does Not Matter Whether Grossman Participated in a Foreign or a Domestic Enterprise

[11] According to Grossman, Congress did not give any indication that it intended for RICO to apply to foreign criminal enterprises, and as a result, the statute does not apply in cases where the relevant enterprise is located outside the United States. (Def. RICO Br. 5–6). Throughout this litigation, Plaintiffs have argued that Grossman participated in a

Brazilian enterprise. (*Id.* at 6). As noted above, Plaintiffs have argued that the relevant enterprise consists of: Grossman, a Brazilian citizen and resident; Roberto Saad, also a Brazilian citizen and resident; and PTI, a Brazilian corporation with an American alter ego. (*Id.*). Grossman characterizes this collection of actors as a foreign—rather than a domestic—enterprise. (*Id.*). Thus, Grossman concludes that he cannot be held liable under RICO. (*Id.*).

***10** This argument is inconsistent with the Supreme Court's analysis in *RJR Nabisco*, where the Court expressly held that "Congress did not limit RICO to domestic enterprises." *RJR Nabisco*, 136 S.Ct. at 2104. As the Court explained, it would be extremely difficult to determine whether an enterprise requirement is foreign or domestic because "RICO association-in-fact enterprises ... need not have a hierarchical structure or a chain of command," and such loosely constructed entities may not have an easily identifiable "nerve center" in one particular location. (*Id.* at 2104–05 (internal quotation marks omitted)). In addition, "[a] domestic enterprise requirement would lead to ... counterintuitive results":

> Imagine, for example, that a foreign corporation has operations in the United States and that one of the corporation's managers in the United States conducts its U.S. affairs through a pattern of extortion and mail fraud. Such domestic conduct would seem to fall well within what Congress meant to capture in enacting RICO. Congress, after all, does not usually exempt foreigners acting in the United States from U.S. legal requirements. *See* 764 F.3d at 138 ("Surely the presumption against extraterritorial application of United States laws does not command giving foreigners carte blanche to violate the laws of the United States in the United States"). Yet [a domestic enterprise requirement] would insulate this scheme from RICO liability[.]

Id. at 2104. These "practical problems" with a domestic enterprise requirement bolstered the Court's "conclusion, based on RICO's text and context, that Congress intended the prohibitions in 18 U.S.C. §§ 1962(b) and (c) to apply extraterritorially in tandem with the underlying predicates, without regard to the locus of the enterprise." (*Id.* at 2105). Thus, Grossman cannot escape RICO liability merely because he participated in a Brazilian enterprise.

iv. Plaintiffs' RICO Case Does Not Turn on Extraterritorial Applications of the Wire Fraud Statute

Construed liberally, Grossman's briefs suggest that this case involves an impermissible extraterritorial application of RICO because: (i) the RICO predicates at issue in this case are instances of mail fraud; (ii) the mail fraud statute only applies domestically; and (iii) a reasonable jury could not find that Grossman engaged in domestic conduct relevant to the "focus" of the mail fraud statute. *RJR Nabisco*, 136 S.Ct. at 2101. (*See, e.g.*, Def. RICO Br. 5 ("This case[ ] [is] cobbled together out of mail-fraud allegations [.]"); *id.* ("[T]here is no basis for finding ... that the mail fraud statute appl[ies] extraterritorially." (internal quotation marks omitted)); *id.* ("This case ... is a foreign dispute that is beyond the domestic focus of RICO.")). To the extent Grossman is raising this argument, the Court now rejects it.

[12] It is undisputed that the RICO predicates at issue here are violations of the mail fraud statute, 18 U.S.C. § 1341, and that the mail fraud statute only applies domestically. (Def. RICO Br. 5; Pl. RICO Opp. 13). *See European Cmty. v. RJR Nabisco, Inc.*, 764 F.3d 129, 141 (2d Cir. 2014) ("[W]e see no basis for finding a manifestation of congressional intent that the mail fraud statute apply extraterritorially."), *rev'd and remanded on other grounds*, —— U.S. ——, 136 S.Ct. 2090, 195 L.Ed.2d 476. Consequently, the Court must determine whether a reasonable jury could find that Grossman engaged in conduct relevant to the focus of the mail fraud statute.

[13] The Second Circuit has held that the "essential elements" of mail fraud are: "[i] a scheme to defraud, [ii] money or property as the object of the scheme, and [iii] use of the mails ... to further the scheme." *United States v. Binday*, 804 F.3d 558, 569 (2d Cir. 2015) (quoting *Fountain v. United States*, 357 F.3d 250, 255 (2d Cir. 2004)). Thus, the mail fraud statute forbids a particular class of frauds (i.e., frauds that are designed to take money or property, and that involve the U.S. mails). These frauds are properly considered the "focus" of § 1341.[4] *See Morrison*, 561 U.S. at 267, 130 S.Ct. 2869 (suggesting that the "focus" of a statute is the set of transactions that the statute seeks to "regulate"); *Chevron Corp. v. Donziger*, 974 F.Supp.2d 362, 571 (S.D.N.Y. 2014) (same).

***11** **[14]** It is not entirely clear what sort of domestic conduct is "relevant" to this statutory focus. *RJR Nabisco*, 136 S.Ct. at 2101. The Supreme Court and the Second Circuit have cautioned that minimal domestic conduct may not be "relevant" to a statute's focus, even if the conduct advances a plan to violate the statute. *See Morrison*, 561 U.S. at 266, 130 S.Ct. 2869 (explaining that the presumption against extraterritoriality applies even where "*some* domestic activity is involved in [a] case"); *Petroleos Mexicanos v. Conproca S.A. de C.V.*, 572 Fed.Appx. 60, 61 (2d Cir. 2014) (summary order) (holding that wire fraud can occur extraterritorially, even if money is wired from a U.S. bank in furtherance of a fraudulent scheme). Thus, the Court believes that a defendant commits conduct "relevant" to the focus of the mail fraud statute only when: (i) the defendant commits a substantial amount of conduct in the United States; and (ii) the conduct is integral to the commission of a fraud; and (iii) at least some of the conduct involves the use of the U.S. mails.

[15] Applying these principles, the Court believes that the record contains adequate evidence that Grossman committed a substantial amount of conduct in the United States, and the conduct was integral to the commission of his fraud. Grossman testified that he specifically established IBIS—a New York Corporation—so that he could pay for the fraudulent subscription orders. (Tr. 348–50). In addition, Grossman testified that IBIS had an "office" in Garden City, New York and that he occasionally received journals at this office, before redirecting them to Brazilian end users. (*Id.* at 342, 348–50). Without the use of IBIS and its office, Grossman's fraud would have been foiled by Brazilian regulations and, occasionally, by quirks in the Brazilian postal system. (*Id.*). *Cf. Chevron Corp.*, 974 F.Supp.2d at 574–75 (finding that the defendants had violated criminal laws domestically in part because, "[a]bsent the[ir] U.S. activity ... [the fraud] ... would have been doomed to failure"). And as explained above, at least some of Grossman's conduct involved the use of U.S. mails: The fraudulent subscription orders at issue in this case were mailed to Elsevier's office in the United States. (*See, e.g.*, Ex. 12, 17, 23, 31, 34, 38, 42). Thus, it is safe to say that Defendants committed domestic conduct relevant to the focus of the mail fraud statute.

It is important to note, however, that even if Defendants committed a substantial portion of their mail fraud in the United States, that does not necessarily mean that Plaintiffs were injured in the United States. *See, e.g.*, *Pasquantino v. United States*, 544 U.S. 349, 371, 125 S.Ct. 1766, 161 L.Ed.2d 619 (2005) (noting that defendants "execute[d]" a fraud in the United States, but the fraud caused injury to the Canadian Government—presumably in Canada). For the reasons explained below, the Court does not believe Plaintiffs have proven that they suffered injury on U.S. soil.

v. Plaintiffs Did Not Plead or Prove a Domestic Injury to Business or Property

Grossman also contends that he is entitled to judgment as a matter of law on the RICO claim because Plaintiffs did not plead or prove a domestic injury to their "business or property." 18 U.S.C. § 1964(c). (*See* Def. Supp. Br. 2–4). The Court agrees.

A. Defining "Domestic Injury"

As Plaintiffs note, there is no established test for determining whether an injury to business or property occurs domestically. (Pl. Supp. Br. 3–4). *See also RJR Nabisco*, 136 S.Ct. at 2111 (declining to explain what constitutes a "domestic injury" in the RICO context). However, Plaintiffs contend that this Court should look to the test that courts use to determine whether an antitrust injury occurs within the United States. (Pl. Supp. Br. 3–6). Plaintiffs explain that the Supreme Court has "often looked to antitrust law 'for guidance in construing § 1964(c).' " (*Id.* at 4 (quoting *RJR Nabisco*, 136 S.Ct. at 2109)). And the Supreme Court has already defined "domestic injury" in the antitrust context: Under the Foreign Trade Antitrust Improvements Act ("FTAIA"), 15 U.S.C. § 6a, an antitrust injury is domestic in nature if it: "[i]

sufficiently affects American commerce, *i.e.*, it has a 'direct, substantial, and reasonably foreseeable effect' on American domestic, import, or (certain) export commerce, *and* [ii] has an effect of a kind that antitrust law considers harmful, *i.e.*, the 'effect' must 'giv[e] rise to a [Sherman Act] claim.' " *F. Hoffmann–La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 162, 124 S.Ct. 2359, 159 L.Ed.2d 226 (2004) (quoting 15 U.S.C. § 6a) (emphasis in original). Reasoning by analogy, Plaintiffs contend that, in the RICO context, an individual has suffered a domestic injury if: "[a] pattern of racketeering activity (i) ha[d] a 'direct, substantial, and reasonably foreseeable effect' on U.S. commerce, and (ii) ha[d] an effect that g[ave] rise to a RICO claim." (Pl. Supp. Br. 6 (quoting *F. Hoffmann–La Roche Ltd.*, 542 U.S. at 162, 124 S.Ct. 2359)).

***12** The Court cannot accept Plaintiffs' proposed test. While it is true that the Supreme Court often looks to antitrust law for guidance in construing RICO, the Court made plain in *RJR Nabisco* that antitrust statutes and RICO provisions are "not ... interchangeable." 136 S.Ct. at 2109.[5] Precisely for this reason, the Supreme Court "ha[s] declined to transplant features of the Clayton Act's cause of action into the RICO context where doing so would be inappropriate." *Id.* And in this Court's view, it would be similarly inappropriate to model the test for "domestic injury" in the RICO context after the test for domestic injury in the antitrust context.

[16] **[17]** For a private plaintiff to recover damages from an antitrust violation, the plaintiff must allege that he or she sustained an "antitrust injury." *Brunswick Corp. v. Pueblo Bowl–O–Mat, Inc.*, 429 U.S. 477, 489, 97 S.Ct. 690, 50 L.Ed.2d 701 (1977). In other words, the plaintiff must allege an injury that "reflect[s] the anticompetitive effect" of the defendant's conduct or the acts made possible by the defendant's conduct. *Id.* Because an "antitrust injury" is one that diminishes the competitive nature of a commercial market, it makes sense to say that an "antitrust injury" occurs domestically when it has a "direct, substantial, and reasonably foreseeable effect" on U.S. commerce. *F. Hoffmann–La Roche Ltd.*, 542 U.S. at 162, 124 S.Ct. 2359.

***13** **[18]** By contrast, a private RICO plaintiff has broad latitude to allege *any* injury to her "business *or* property," so long as those injuries were caused by the defendant's commission of RICO predicates (and that the predicates were committed under circumstances giving rise to RICO liability). *See* 18 U.S.C. § 1964; *see also Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495, 105 S.Ct. 3275, 87 L.Ed.2d 346 (1985). Some of these injuries might be the kind of injuries that distort commercial markets, but others may not. For example, imagine that the owner of a small company (operating in interstate commerce) extorts his landlord once a year to get a good deal on his rent. If the company is small enough, the extortion might not have a "substantial" effect on U.S. commerce; nevertheless, it could still cause substantial harm to the landlord's business, and this seems to be the type of harm that § 1964 was designed to remedy. *See Sedima*, 473 U.S. at 495, 105 S.Ct. 3275 (discussing the broad remedial purposes of § 1964); *id.* (stating, categorically and without exception, that when a "defendant engages in a pattern of racketeering activity in a manner forbidden by [§ 1962], and the racketeering activities injure the plaintiff in his business or property, the plaintiff has a claim under § 1964(c)").

[19] The Court concludes that, in the RICO context, courts should employ a more flexible inquiry to determine where an injury occurs. First, the court should determine what type of injury a RICO plaintiff has suffered. If the plaintiff has suffered an injury to his or her business, the court should ask where substantial negative business consequences occurred. By contrast, if the plaintiff has suffered an injury to his or her property, the court should ask where the plaintiff parted with the property or where the property was damaged.

B. The Injuries in This Case

The record indicates that Plaintiffs suffered two injuries from Defendants' pattern of racketeering activity: (i) their business suffered a competitive injury; and (ii) they parted with their property in reliance on Defendants' fraudulent statements.[6] Unfortunately for Plaintiffs, the evidence at trial indicates that neither of these injuries occurred on U.S. soil.

1. Competitive Injury

[20] First, the record suggests that Plaintiffs suffered a competitive injury: Brazilian institutions purchased journal subscriptions from Defendants at a discounted rate, rather than purchasing them from Plaintiffs for the full institutional price. However, all of the evidence in the record suggests that this injury occurred in Brazil. (Def. Supp. Br. 2–4). The journal subscriptions at issue in this case were ultimately sold to Brazilian institutions (*see* Ex. 7), and there is no evidence suggesting that Defendants ever sold or attempted to sell journals to institutions outside of Brazil. Nor is there any evidence that the market for journals in Brazil is so closely intertwined with the market for journals in other countries that disruptions in the Brazilian market would have an effect on the price or quantity of journals sold to institutions in other countries. Thus, the Court cannot say that Plaintiffs suffered any negative business consequences in any country but Brazil. *Cf., e.g., Darby Trading Inc. v. Shell Int'l Trading & Shipping Co.*, 568 F.Supp.2d 329, 336–37 (S.D.N.Y. 2008) (suggesting, in the personal jurisdiction context, that injury to a plaintiff's business occurs in New York when the plaintiff loses sales and customers "in the New York market"); *Energy Brands Inc. v. Spiritual Brands, Inc.*, 571 F.Supp.2d 458, 467 (S.D.N.Y. 2008) (same).

*14 Plaintiffs seem to suggest that the racketeering activity in this case affected their U.S. business because: (i) Defendants placed their fraudulent subscription orders from the United States; and (ii) some of the journals at issue in this case were mailed to Grossman's apartment in Garden City, New York. (Pl. Supp. Br. 6–9). Neither of these contentions has merit.

Turning to the first contention, Plaintiffs argue that Grossman established IBIS so that he could transfer money from Brazil to the United States; thus, it is fair to presume that IBIS placed fraudulent subscription orders (on behalf of the enterprise) from the United States. (Pl. Supp. Br. 6–7). According to Plaintiffs, this presumption is "borne out by the documentary evidence, which reflects that ... 38 out of the 51 fraudulent subscriptions [at issue here] were purchased with an IBIS check, issued by IBIS and drawn upon IBIS's checking account maintained with JP Morgan Chase through a New York-based branch." (Pl. Supp. Br. 7).

As an initial matter, the Court cannot conclude that Grossman, IBIS, or any other Defendant falsified subscription orders in the United States simply because Defendants paid for those subscriptions with checks drawn on a U.S. bank account. *Cf. Petroleos Mexicanos*, 572 Fed.Appx. at 61 (holding that wire fraud occurred outside the United States, even though defendants caused money to be wired from a U.S. bank account). At trial, Grossman testified that PTI employees in Brazil filled out the subscription forms, and these PTI employees simply funneled money through the IBIS account. (*See* Tr. 348–50). This testimony is consistent with the representations that Plaintiffs made to this Court in connection with their application for a writ of attachment. (*See* Dkt. # 156 at 7 (Plaintiffs explaining that the subscription orders at issue in this case were "placed by PTI" and that "in a real sense," the funds in the IBIS account were "PTI funds")). Thus, the Court will not now countenance an argument that IBIS, as an entity independent from PTI, was falsifying order forms from the United States on behalf of various clients. *See Crawford v. Franklin Credit Mgmt. Corp.*, 758 F.3d 473, 485–86 (2d Cir. 2014) ("Judicial estoppel generally prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument to prevail in another phase." (quoting *Pegram v. Herdrich*, 530 U.S. 211, 227 n.8, 120 S.Ct. 2143, 147 L.Ed.2d 164 (2000))).

However, even if the fraudulent subscriptions were ordered from the United States, it does not follow that Plaintiffs were injured in the United States. The Second Circuit has recognized (albeit in a different context) that it is possible for fraudulent conduct to take place in one location, but cause injury in another location. *See Bank Brussels Lambert v. Fiddler Gonzalez & Rodriguez*, 171 F.3d 779, 791–92 (2d Cir. 1999). Similarly, the Supreme Court has indicated that fraudulent conduct in the United States can cause harm to foreign governments, presumably on foreign soil. *See Pasquantino*, 544 U.S. at 371, 125 S.Ct. 1766. Thus, even if Defendants falsified subscription orders on U.S. soil, Plaintiffs still have to prove that the falsified subscription orders had some effect on Plaintiffs' relationships with actual or prospective U.S. customers. But there is no such proof in the record. Rather, as discussed above, the record suggests that Defendants' conduct only affected Plaintiffs' relationships with Brazilian institutions.

*15 Alternatively, Plaintiffs contend that Defendants' conduct affected their U.S. business because some of the journals at issue in this case were mailed to Grossman's apartment in Garden City, New York. (Pl. Supp. Br. 8–9). However, the record indicates that the journals were never used in New York; instead, they were received at the Garden City apartment, which acted as a sort of postal station in Defendants' enterprise, and then shipped on to Brazilian institutions. (*See* Tr. 322 (Pitts testifying that "PTI [was] consolidating subscriptions in the U.S. at [the] U.S. addresses. They were then being sent down to Brazil and they were being sold in Brazil."); *id.* at 348–50 (Grossman testifying that he sometimes used the Garden City apartment as a shipping address for orders placed on behalf of Brazilian customers if he believed that "the Post Office [wouldn't] work in Brazil for delivery")). Consequently, Plaintiffs have failed to show that Defendants' conduct affected the market for Plaintiffs' products in any country other than Brazil. [7]

2. Parting with Property Under False Pretenses

[21] Plaintiffs were also injured when they parted with their journals in reliance on Defendants' fraudulent statements. *Cf., e.g., Bank Brussels Lambert*, 171 F.3d at 792 (noting that a plaintiff is injured when he or she parts with money in reliance on fraudulent statements); *accord Hargrave v. Oki Nursery, Inc.*, 636 F.2d 897, 900 (2d Cir. 1980); *Palace Expl. Co. v. Petroleum Dev. Co.*, 41 F.Supp.2d 427, 435–36 (S.D.N.Y. 1998). The evidence introduced at trial suggests that Plaintiffs parted with their journals, in exchange for a relatively modest amount of money, because they believed Defendants' statements that the journals would be used by individuals; had Plaintiffs known that the journals would be given to institutions, they would not have parted with the journals for such a low price. (*See* Tr. 151–53).

To determine whether this injury occurred domestically, the Court must determine where Plaintiffs parted with the journals at issue in this case. Plaintiffs claim in their supplemental briefing that they parted with the journals in the United States. (*See* Pl. Supp. Br. 10 ("Elsevier relied on [Defendants'] fraudulent subscriptions in the United States by issuing journals for the discounted individual price[.]")). But the evidence in the record does not support this assertion. While Guman testified that Plaintiffs' journals are "sent via the post," he did not specify that the journals were sent through the *American* postal service, or otherwise suggest that Plaintiffs shipped their products from the United States. More importantly, the record contains some indications that Plaintiffs parted with the journals in the Netherlands. Thirteen of the invoices that Plaintiffs submitted to the jury indicate that the "shipping method" for the journals that Plaintiffs sent to Defendants was "Dutch PTT/Stan." (Ex. 11, 14–15, 19–22, 24, 27–28, 37, 39, 40). [8] This strongly suggests that the journals (or at least the journals described in those 13 invoices) were mailed through the Dutch PTT (the Dutch postal service). It is not clear why Plaintiffs would use the Dutch postal service to ship journals to addresses in New York and Brazil unless Plaintiffs were sending journals *from* the Netherlands to the United States and Brazil. Thus, there is reason to believe that the journals left Plaintiffs' control in the Netherlands.

[22] The Court is sensitive to the concern that, when a court determines where a corporation parts with its goods, the court should look to the place where corporate employees authorize the shipment of goods, rather than the place where the goods happen to be stored. Consequently, if Plaintiffs could demonstrate that a U.S. employee authorized warehouse workers (in the Netherlands or elsewhere) to ship journals to Defendants, it might be fair to say that Plaintiffs parted with those journals in the United States. But the record does not show that a U.S. employee authorized the shipments at issue in this case. Guman testified that, when Plaintiffs receive subscription orders, the orders are "actually process[ed]" through a "[f]ulfillment system." (Tr. 165). Plaintiffs maintain four different fulfillment systems (Tr. 170), but it is not clear where those fulfillment systems are located. And the record indicates that at least some of the fulfillment systems that processed Defendants' fraudulent subscription orders were located abroad: 14 of the invoices include a line that reads, "Registered in England Number 1982084 Elsevier, Fulfillment Centre, The Boulevard, Kidlington, Oxford, OX5, 1GB UK." (Ex. 11, 14–15, 19–22, 24, 27–28, 35, 37, 39–40). At the same time, the evidence suggests that some of the subscriptions that PTI ordered were processed by a fulfillment center called "Elsevier France." (*See* Ex. 4). Thus, there is reason to believe that, for at least some of the subscriptions at issue here, the employees who authorized the shipment of the journals were located at fulfillment centers in England or France. The record does not provide any analogous indication that employees who authorized the shipment of other journals were located in the United States.

***16** Plaintiffs ask the Court to infer that they parted with their journals in the United States because Defendants mailed their fraudulent subscription orders and their checks to an address in the United States. (*See* Pl. Supp. Br. 10). But the Court cannot draw such an inference, even with the generous prism through which Plaintiffs' trial evidence must be viewed. The evidence submitted at trial is fully consistent with a scenario in which: (i) Plaintiffs received subscription orders and checks in the United States; (ii) a customer service representative in the United States notified a foreign fulfillment center that the order and the payment had been received; and then (iii) an employee at a foreign fulfillment center authorized the shipment of journals to the customers. (*See* Tr. 166 (explaining that "information that's in [a] fulfillment system[ ] ... come[s] from [a] customer service representative that actually takes the order")). As noted above, while Defendants sent their checks and orders to U.S. addresses, it appears that the bulk of the orders were processed by foreign fulfillment systems. Furthermore, the record reveals that, when Defendants ordered some of their subscriptions, they had a choice between mailing a check to the United States and wiring the money directly to Plaintiffs' bank account in the Netherlands. (*See* Ex. 11, 14–15, 19–22, 24, 28, 35). This suggests that Defendants were not dealing solely with the American arm of Plaintiffs' publishing business; they were dealing with an integrated, international publishing operation. Consequently, there is not enough evidence in the record for a reasonable jury to conclude that a U.S. employee provided final authorization to ship journals to Defendants. [9]

3. The Potential Remedy of a New Trial

Plaintiffs' supplemental brief contends that, to the extent Plaintiffs have failed to prove that they suffered a domestic injury, they are entitled to a new trial under Federal Rule of Civil Procedure 59. (Pl. Supp. Br. 17–18). Rule 59 gives a court discretion to "grant a new trial on all or some of the issues" in a case "for any reason for which a new trial has heretofore been granted in an action at law in federal court." Fed. R. Civ. P. 59. The Second Circuit has recognized that an "intervening change in controlling law" can be an appropriate basis for granting a new trial under Rule 59. *LiButti v. United States*, 178 F.3d 114, 119 (2d Cir. 1999); *see also Sass v. MTA Bus Co.*, 6 F.Supp.3d 229, 238 (E.D.N.Y.), *adhered to on reconsideration*, 6 F.Supp.3d 238 (E.D.N.Y. 2014) (granting a new trial based on a change in the governing law).

At the time of trial in this case, there was no requirement that a RICO plaintiff plead or prove domestic injury to business or property. See *RJR Nabisco*, 136 S.Ct. at 2106 (noting that, prior to the Supreme Court's decision on June 20, 2016, "[t]he Second Circuit thought that the presumption against extraterritoriality did not apply to § 1964(c)"). Furthermore, even if Plaintiffs wanted to hedge their bets at trial by introducing evidence regarding domestic injury—in case the Supreme Court ruling created a domestic injury requirement—they may not have known what evidence to introduce. Now that this Court has offered some guidance on the proof required to establish a domestic injury, Plaintiffs would like an opportunity to show that they suffered a qualifying injury on U.S. soil. (*See* Pl. Supp. Br. 17–18).

***17 [23]** The difficulty with Plaintiffs' request is that they have conceded that the "Amended Complaint did not explicitly plead a domestic injury to business or property." (Pl. Supp. Br. 11). And the Court does not believe that, at this point in the proceedings, it can allow Plaintiffs to correct the deficiency in its pleadings. Federal Rule of Civil Procedure 15(b)(2) provides that a court may allow a party may amend its pleadings "after trial" if the amendment: (i) addresses an issue that was "tried by the parties' express or implied consent"; or (ii) allows a party to "conform [the pleadings] to the evidence" presented to the jury. *See also Hillburn by Hillburn v. Maher*, 795 F.2d 252, 264 (2d Cir. 1986) ("[I]f the [Rule 15(b)] motion is made after trial, and the issues have not been tried with the express or implied consent of the parties, the motion may be granted if the party against whom the amendment is offered will not be prejudiced by the amendment and should be granted in the absence of such prejudice if the interests of justice so require."); *Browning*

Debenture Holders' Comm. v. DASA Corp., 560 F.2d 1078, 1086 (2d Cir. 1977) ("The purpose of Rule 15(b) is to allow the pleadings to conform to issues actually tried, not to extend the pleadings to introduce issues inferentially suggested by incidental evidence in the record."). Here, the Court does not believe that the issue of domestic injury was "tried by the parties' express or implied consent"; and even if the parties consented to try the issue, Plaintiffs lost that trial for the reasons outlined above. Similarly, allowing Plaintiffs to plead domestic injury would not simply conform the pleadings to the evidence introduced at trial (because, at the risk of beating a dead horse, the trial evidence did not establish a domestic injury).

Thus, the Court must consider whether it may order a new trial under Rule 59, limited to the issue of domestic injury, and then—if Plaintiffs prove that they in fact suffered a domestic injury—allow Plaintiffs to amend their pleadings to "conform them to the evidence" introduced at the new trial. The Court believes that it is permissible to proceed in this manner for two reasons.

[24] First, nothing in Rule 59 limits this Court's discretion to grant a new trial on an issue that has not been pleaded, if doing so is necessary to prevent a miscarriage of justice. *See Hygh v. Jacobs*, 961 F.2d 359, 365 (2d Cir. 1992) (noting that a trial court has discretion to grant Rule 59 motions to avoid a "miscarriage of justice" (internal quotation marks omitted)); *Fioto v. Manhattan Woods Golf Enterprises, LLC.*, 304 F.Supp.2d 541, 545 (S.D.N.Y. 2004), *aff'd sub nom. Fioto v. Manhattan Woods Enterprises LLC*, 123 Fed.Appx. 26 (2d Cir. 2005) (summary order) (same). And the Court believes that it would be a miscarriage of justice to throw out Plaintiff's RICO claim against Grossman—after four years of litigation—because Plaintiffs failed to introduce evidence (of a domestic injury) that had been deemed unnecessary by the Second Circuit. *See European Cmty. v. RJR Nabisco, Inc.*, 764 F.3d at 151 (rejecting the idea that § 1964 imposes a domestic injury requirement); *cf. Hawknet, Ltd. v. Overseas Shipping Agencies*, 590 F.3d 87, 91–92 (2d Cir. 2009) (holding that a defendant had not waived an argument that it failed to make in the district court because the argument "would have been directly contrary to controlling precedent in this Circuit" at the time of trial). Under these circumstances, justice demands that Plaintiffs be given some opportunity introduce evidence regarding the location of their injury. *Cf. Sass*, 6 F.Supp.3d at 238 (granting a Rule 59 motion after the Supreme Court changed the standard of proof for Title VII cases).

Second, and relatedly, Rule 15(b) was specifically designed to avoid the "tyranny" of a formalistic system that prioritized perfection in pleading over practical assurances that litigants had a fair opportunity to try their disputes. 6A Charles A. Wright *et al.*, FEDERAL PRACTICE AND PROCEDURE § 1491 (3d ed.); *see also Hillburn*, 795 F.2d at 264 (explaining that the use of Rule 15(b) to amend pleadings after trial "should be granted in the absence of ... prejudice [to any party] ... if the interests of justice so require"). Thus, the Court will not read Rule 15 to prevent it from holding a full and fair trial on the unpleaded domestic injury issue, and then amending the pleadings to conform to the evidence introduced at that trial.

While the Court believes that it would be permissible to order a new trial on the issue of domestic injury at this juncture, it does not believe that it would be advisable to hold a second trial unless Plaintiffs are capable of introducing more information on the issue of domestic injury. Thus, at this point, the Court will grant Grossman's Rule 50 motion for judgment as a matter of law and deny Plaintiffs' Rule 59 motion for a new trial without prejudice: Plaintiffs may renew their Rule 59 motion within 30 days if the motion is accompanied by a proffer of the evidence that would be offered at a trial on the issue of domestic injury.

2. Consistency of the Verdicts

***18** While Grossman did not raise the issue of inconsistent verdicts in his post-trial motions, the Court was troubled by the apparent inconsistency between the jury's responses to some of the questions on the verdict form. Question 4 of the verdict form asked:

> With respect to Count Four (conversion), have the plaintiffs proven by a preponderance of the evidence that (i) the plaintiffs had legal ownership or a possessory right or interest in the property

> (*here, the lost subscription revenues*); and (ii) [Grossman] exercised unauthorized domain over the property or interfered with it in derogation of the plaintiffs' rights?"

(Dkt. # 167 (emphasis added)). The jury answered this question in the affirmative. (*Id.*). As a result, the jury proceeded to answer question 4(a), which asked:

> [D]o you find that the plaintiffs sustained damages—*in the form of lost subscription revenues*—as a proximate consequence of [Grossman's] conversion of the property?

(*Id.* (emphasis added)). The jury answered this question in the negative. (*Id.*). Thus, the Court became concerned that the jury had espoused two irreconcilable factual conclusions: a conclusion that Grossman had impermissibly taken Plaintiffs' subscription revenues, and a conclusion that Grossman's conduct had not caused any damage "in the form of lost subscription revenues." The Court was further concerned that, if the jury had espoused these two factually inconsistent positions, a new trial might be required on some or all of the counts in the Amended Complaint. *See, e.g., Munafo v. Metro. Transp. Auth.*, 381 F.3d 99, 105 (2d Cir. 2004) ("[I]nconsistent special verdict answers raise constitutional concerns because 'proper deference to the parties' Seventh Amendment rights to trial by jury precludes entry of a judgment that disregards any material jury finding.' " (quoting *Tolbert v. Queens Coll.*, 242 F.3d 58, 74 (2d Cir. 2001))). As a result, the Court solicited supplemental briefing from the parties, asking whether the Court could consider the issue of inconsistent verdicts *sua sponte* (particularly in light of Grossman's *pro se* status), and whether the jury's responses to any questions on the verdict form were in fact irreconcilably inconsistent. (Dkt. # 211).

It is not clear whether the Court can consider the issue of inconsistent verdicts *sua sponte* because Grossman is proceeding *pro se*. *Compare Cash*, 654 F.3d at 342 (explaining, in a case with counseled parties, that a party "waives its objection to any inconsistency in a jury verdict if it fails to object to the verdict" before the court excuses the jury (internal quotation marks omitted)), *with Denny v. Ford Motor Co.*, 42 F.3d 106, 111 (2d Cir. 1994) (suggesting a "case-by-case application" of waiver principles in cases involving inconsistent jury verdicts). However, to the extent the Court can consider questions regarding inconsistent verdicts, it concludes that the jury's responses to the questions on the verdict form were *not* irreconcilably inconsistent.

a. The Jury's Verdicts on Question 4 and Question 4(a) Can Be Reconciled with One Another and with the Jury's Other Verdicts

[25] [26] [27] A court cannot set aside an otherwise valid jury verdict unless the jury's answers to special verdict questions are "*ineluctably* inconsistent." *Munafo*, 381 F.3d at 105 (quoting *Tolbert*, 242 F.3d at 74) (emphasis in *Munafo*). "In cases 'where the special verdict answers appear to be inconsistent but there is a view of the case that makes the jury's answers consistent, they must be resolved that way.' " *Id.* (quoting *Tolbert*, 242 F.3d at 74); *accord Cash*, 654 F.3d at 343.

*19 In this case, Plaintiffs have proposed a view of the case that harmonizes the jury's responses to Questions 4 and 4(a): The jury believed that Grossman improperly converted Plaintiffs' subscription revenues, as they indicated in their response to Question 4. However, the jury also wanted to heed the Court's instruction that it is improper to "award compensatory damages more than once for the same injury." (Tr. 481). The jury likely believed that they had already compensated Plaintiffs for the loss of their subscription revenues (either with the damages they awarded on the RICO claim or the damages they awarded on the breach-of-contract claim). Consequently, they decided not to compensate Plaintiffs again by awarding damages on the conversion claim, as reflected in the response to Question 4(a). Taking this view of the case, there is no inconsistency between any of the jury's factual findings. (*See* Pl. Supp. Br. 21)

b. The Jury's Verdicts on the Substantive RICO Count and the RICO Conspiracy Count Can Be Reconciled

[28] In his supplemental brief to the Court, Grossman did not focus his arguments on the potential inconsistency between Questions 4 and 4(a), choosing instead to focus on a perceived inconsistency between the Jury's answer to Question 1 and Question 2. Question 1 asked:

> With respect to Count One (RICO), have the plaintiffs proven by a preponderance of the evidence that (i) an enterprise existed; (ii) the enterprise affected interstate or foreign commerce; (iii) the defendant was associated with or employed by the enterprise; (iv) the defendant engaged in a pattern of racketeering activity; and (v) the defendant conducted, or participated in the conduct of, the enterprise through that pattern of racketeering activity?

(Dkt. # 167). The jury's answer to this question was "yes." (*Id.*). By contrast, Question 2 asked:

> With respect to Count Two (RICO conspiracy), have the plaintiffs proven by a preponderance of the evidence that (i) there was an agreement between two or more persons or entities to participate in an enterprise that would affect interstate or foreign commerce through a pattern of racketeering activity; (ii) the defendant knowingly and willfully became a member of that agreement; and (iii) the defendant or another member of the conspiracy agreed to commit two racketeering acts?

(*Id.*). The jury's answer to this question was "no." (*Id.*).

Grossman argues that, on the facts of this case, the jury's responses to these two questions were irreconcilably inconsistent. (Def. Supp. Br. 5–7). As Grossman explains, the RICO enterprise at issue here was an association-in-fact between and among Grossman, Roberto Saad, and PTI/IBIS. However, "[w]ithout a RICO conspiracy—an 'agreement ... to participate in [the] enterprise' —" this association in fact could not have existed. (*Id.* at 5 (quoting Tr. 472)). As a result, Grossman concludes, it was inconsistent for the jury to find that Grossman was "associated with or employed by an enterprise," but not liable for a RICO consistency. (*Id.* at 5–7). The Court disagrees.

Based on the record here, the jury could have determined that Grossman, Roberto Saad, and other PTI/IBIS employees agreed to form an enterprise (namely, a subscription business), but that they did *not* agree to conduct the enterprise's affairs through a pattern of racketeering. Instead, Grossman made a unilateral decision to conduct (at least some) subscription sales in a fraudulent manner. Such a situation would give rise to substantive RICO liability, but not liability for participating in a RICO conspiracy. *Cf. United States v. Sessa*, 125 F.3d 68, 71 (2d Cir. 1997) ("There are significant distinctions between the proof necessary to show that a defendant conspired to violate RICO and the evidence required to prove an actual violation of that statute" (internal quotation marks omitted)).[10]

3. The Court Denies Plaintiffs' Damages Motion

***20** Because the Court has concluded at this juncture that Plaintiffs have failed to establish RICO liability, their request for judgment as a matter of law, or in the alternative, a new trial solely on the issue of RICO damages, must be denied.

4. The Court Grants in Part and Denies in Part Plaintiffs' Motion for Final Default Judgment

Plaintiffs' Motion for Final Default Judgment against PTI and IBIS is denied as to the RICO claim and the RICO conspiracy claim, but granted as to the breach-of-contract claim.

a. The RICO and RICO Conspiracy Claims

Plaintiffs cannot obtain final default judgment on the RICO claim or the RICO conspiracy claim because they have admitted that the "Amended Complaint d[oes] not explicitly plead a domestic injury to business or property." (Pl. Supp.

Br. 11). In other words, Plaintiffs have admitted that, under current law, the Amended Complaint does not state a RICO claim. This Court cannot enter final judgment based on a defective pleading. *See Cement & Concrete Workers Dist. Council Welfare Fund, Pension Fund, Annuity Fund, Educ. & Training Fund & Other Funds v. Metro Found. Contractors Inc.*, 699 F.3d 230, 234 (2d Cir. 2012) ("*Cement & Concrete Workers* ") (explaining that "a party's default is deemed to constitute a concession of all well pleaded allegations of liability" (internal quotation marks omitted)). And the Court is not obligated to do so merely because it entered a non-final default judgment in May of 2015. (*See* Dkt. # 80). *See also* Fed. R. Civ. P. 54(b) ("When an action presents more than one claim for relief ... or when multiple parties are involved, the court may direct entry of a final judgment as to one or more, but fewer than all, claims or parties only if the court expressly determines that there is no just reason for delay. Otherwise, any order or other decision, however designated, that adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties does not end the action as to any of the claims or parties and may be revised at any time before the entry of a judgment adjudicating all the claims and all the parties' rights and liabilities.").

However, because Plaintiffs have not yet been to trial against PTI and IBIS, the Court will not dismiss the RICO and RICO conspiracy claims against PTI and IBIS outright; instead, within 30 days of the date of this Order, Plaintiffs may apply for leave to amend their pleadings (against PTI and IBIS) to allege domestic injury to business or property. *See* Fed. R. Civ. P. 15(a)(2) (providing that, before trial, a court should "freely give leave [to amend the pleadings] when justice so requires"); *supra* at 42–43 (explaining why Plaintiffs should be given an opportunity to plead and prove a domestic injury to business or property).

b. The Breach-of-Contract Claim

Plaintiffs' Motion for Final Default Judgment against PTI and IBIS on the breach-of-contract claim is granted. Because the Court believes that the breach-of-contracts claim is well pleaded, PTI's and IBIS's defaults are tantamount to admissions of liability on those claims. *See Cement & Concrete Workers*, 699 F.3d at 234. More specifically, they are tantamount to admissions that PTI and IBIS violated the terms of the subscription contracts listed in the Amended Complaint, Exhibit A.

***21** For some of the subscription contracts described in Exhibit A, Plaintiffs state that they are not seeking damages. For example, Plaintiffs candidly admit that, following discovery, Plaintiffs no longer believe that the subscription contracts listed in "Ex. A, lines 10[ ] [and] 16–31" are fraudulent. (Pl. Default Br. 10, n.4). In addition, Plaintiffs state that they are not seeking damages for fraudulent subscription contracts that were personally signed by Grossman. (*Id.* at 15–16). Thus, Plaintiffs are only seeking damages with respect to 28 of the subscription contracts in Exhibit A. (*See* Am. Compl., Ex. A, lines 2–7, 9, 11, 13–15, 33–41, 43–44, 46–51 (hereafter, the "Exhibit A subscriptions")).

Plaintiffs also attempt to seek contract damages for "eight additional personal rate subscriptions that corresponded to institutional rate subscriptions listed on the defendants' 148–page spreadsheet. [*See* Trial Ex. 10, lines 45–52.]." (Pl. Default Br. 10, n.4). But Plaintiffs cannot obtain damages with respect to contracts that were not mentioned anywhere in the Amended Complaint. PTI's and IBIS's defaults were only tantamount to admissions that they breached the contracts described in the Amended Complaint; they were *not* tantamount to admissions that they breached any other contracts (such as the eight additional contracts that Plaintiffs identified during discovery), and if Plaintiffs would like to seek damages related to these eight additional contracts, they will have to bring a new civil suit.

[29] Consequently, the Court must determine how much Plaintiffs are owed for violations of the 28 Exhibit A subscriptions (and only those subscriptions). The Court will calculate these damages by taking the full institutional price that PTI and IBIS should have paid for the subscriptions, and subtracting the discounted individual price that PTI and IBIS actually paid. (*See* Ex. 10 (listing the institutional price and the individual price for many subscriptions, including the 28 subscriptions at issue here)). Using this method, the Court has determined that PTI and IBIS owe $22,854 in damages.

Consequently, Plaintiffs now have a final default judgment against PTI and IBIS, based on the breach-of-contract claim in the Amended Complaint, in the amount of $22,854, plus prejudgment interest. *See* N.Y.C.P.L.R. § 5001. Within 30 days of the date of this Opinion and Order, the parties must submit their proposed interest calculations to the Court.

5. The Court Denies Plaintiffs' Fee Motion

Because Plaintiffs have not prevailed on any RICO claim, the Fee Motion is denied, though it may be renewed depending on the resolution of subsequent motion practice.

CONCLUSION

For the foregoing reasons, the RICO Motion is granted; the Damages Motion is denied; the Motion for Final Default Judgment is granted in part and denied in part; and the Fee Motion is denied. If Plaintiffs wish to file a renewed motion for a new trial against Defendant Grossman under Rule 59, or for leave to amend the pleadings as to PTI or IBIS under Rule 15, they may do so within 30 days. In addition, the parties must submit their proposed interest calculations to the Court within 30 days. The parties are directed to appear for a telephone conference on **August 16, 2016, at 10:00 a.m.** to discuss the next steps in this case.

The Clerk of Court is directed to terminate the motions at docket entries 185, 187, 189, and 192.

SO ORDERED.

All Citations

--- F.Supp.3d ----, 2016 WL 7077109

Footnotes

[1] The facts in this Opinion are drawn from the trial transcript ("Tr.") and the trial exhibits ("Ex."), unless otherwise indicated. For convenience, the Court will refer to Grossman's brief in support of the RICO Motion as "Def. RICO Br." (Dkt. # 194), Plaintiffs' brief in opposition to the RICO Motion as "Pl. RICO Opp." (Dkt. # 204), and Grossman's reply as "Def. RICO Reply" (Dkt. # 208). In addition, the Court will refer to Plaintiffs' brief in support of the Damages Motion as "Pl. Damages Br." (Dkt. # 186) and Plaintiffs' brief in support of the Motion for Final Default Judgment as "Pl. Default Br." (Dkt. # 188). (Defendants did not submit any opposition to these motions.) Similarly, the Court will refer to Plaintiffs' brief in support of the Fee Motion as "Pl. Fee Br." (Dkt # 190); Grossman's opposition to the Fee Motion as "Def. Fee Opp." (Dkt # 205); and Plaintiffs' reply as "Pl. Fee Reply" (Dkt. # 206). Finally, the Court will refer to Plaintiffs' response to the Court's request for supplemental briefing as "Pl. Supp. Br." (Dkt. # 219) and Defendant's response to the Court's request as "Def. Supp. Br." (Dkt. # 220).

[2] The funds in the IBIS account are now the subject of an interpleader proceeding in this Court, *JPMorgan Chase Bank, N.A. v. John Wiley & Sons, Inc., et al.*, No. 16 Civ. 4201 (KPF).

[3] Because there may have been some delay in processing Grossman's papers through the District's *Pro Se* Office, the Court will presume that his papers were filed on the dates provided in the documents themselves, rather than the dates appearing on the docket sheet.

[4] Some courts in other jurisdictions have suggested that the "focus" of § 1341 is the use of the U.S. mails. *See, e.g., United States v. Coffman*, 771 F.Supp.2d 735, 738–39 (E.D. Ky. 2011). But this Court is not convinced that the use of the U.S. mails, without more, can be considered conduct relevant to the "focus" of the mail fraud statute. As its title indicates, § 1341, is aimed at "frauds and swindles." To be sure, the statute addresses a limited set of "frauds and swindles"—namely, those involving

the U.S. mails. However, in singling out this type of fraud, Congress did not shift the focus of the statute away from fraud. Rather, Congress narrowed the focus of the statute from all fraud to fraud facilitated by the U.S. mails. Thus, the use of U.S. mails is a necessary but not sufficient condition for criminal liability under § 1341. *Cf. Petroleos Mexicanos v. Conproca S.A. de C.V.*, 572 Fed.Appx. 60, 61 (2d Cir. 2014) (summary order) (finding no domestic violation of the wire fraud statute despite the fact that U.S. wires were used to further a fraud).

5 *See also RJR Nabisco, Inc. v. European Cmty.*, ––– U.S. ––––, 136 S.Ct. 2090, 2109–10, 195 L.Ed.2d 476 (2016):

> There is good reason not to interpret § 1964(c) to cover foreign injuries just because the Clayton Act does so. When we held in [*Pfizer Inc. v. Government of India*, 434 U.S. 308, 98 S.Ct. 584, 54 L.Ed.2d 563 (1978)] that the Clayton Act allows recovery for foreign injuries, we relied first and foremost on the fact that the Clayton Act's definition of "person"—which in turn defines who may sue under that Act—"explicitly includes 'corporations and associations existing under or authorized by ... the laws of any foreign country.' " 434 U.S. at 313, 98 S.Ct. 584; *see* 15 U.S.C. § 12. RICO lacks the language that the *Pfizer* Court found critical. *See* 18 U.S.C. § 1961(3). To the extent that the *Pfizer* Court cited other factors that might apply to § 1964(c), they were not sufficient in themselves to show that the provision has extraterritorial effect. For example, the *Pfizer* Court, writing before we honed our extraterritoriality jurisprudence in *Morrison* and *Kiobel*, reasoned that Congress "[c]learly ... did not intend to make the [Clayton Act's] treble-damages remedy available only to consumers in our own country" because "the antitrust laws extend to trade 'with foreign nations' as well as among the several States of the Union." 434 U.S. at 313–314, 98 S.Ct. 584. But we have emphatically rejected reliance on such language, holding that " 'even statutes ... that expressly refer to "foreign commerce" do not apply abroad.' " *Morrison*, 561 U.S. at 262–263, 130 S.Ct. 2869. This reasoning also fails to distinguish between extending substantive antitrust law to foreign conduct and extending a private right of action to foreign injuries, two separate issues that, as we have explained, raise distinct extraterritoriality problems. *See supra*, at 2105–2108. Finally, the *Pfizer* Court expressed concern that it would "defeat th[e] purposes" of the antitrust laws if a defendant could "escape full liability for his illegal actions." 434 U.S. at 314, 98 S.Ct. 584. But this justification was merely an attempt to "divin[e] what Congress would have wanted" had it considered the question of extraterritoriality—an approach we eschewed in *Morrison*, 561 U.S. at 261, 130 S.Ct. 2869. Given all this, and in particular the fact that RICO lacks the language that *Pfizer* found integral to its decision, we decline to extend this aspect of our Clayton Act jurisprudence to RICO's cause of action.

6 The Amended Complaint also alleges that Defendants deprived Plaintiffs of intellectual property—the names of the actual end users of the journals. At trial, however, Plaintiffs did not seek damages for the loss of this intellectual property. (*See* Tr. 438–39, 480–81). Instead, Plaintiffs requested damages that consisted of the difference between the price that certain (identified) Brazilian institutions should have paid for journal subscriptions, and the price that those institutions actually paid. (*See id.*). Consequently, the Court has not considered the alleged loss of intellectual property in its analysis. The Court notes for the record, however, that the loss of this intellectual property apparently occurred in Brazil, where Defendants falsified the names on their subscription forms.

7 Thus, even if the Court had accepted Plaintiffs' proposed test for a domestic RICO injury, the Court would not have found that Defendants' conduct had a direct, substantial, and reasonably foreseeable effect on U.S. commerce.

8 A fourteenth invoice lists "DHL Omega" as the shipping method for some of the journals that Defendants ordered. (Ex. 35). While DHL is a German shipping company, it has operations all over the world; consequently, that particular shipping designation does not provide much insight.

9 It is true that, for at least some of the journals that Elsevier sent to Plaintiffs, "[l]egal and beneficial title" to the journals "remain [ed] with Elsevier until Elsevier ha[d] received in full (in cash or cleared funds) all sums due [for the journals]." (Ex. 11, 13–16,19–20, 22, 24, 27–28, 32–33, 35, 37, 39–40, 43). Because Plaintiffs sent their checks to U.S. addresses, a reasonable jury might be able to infer that Elsevier cashed or cleared those checks in the United States. In other words, a reasonable jury might be able to infer that *title* to the disputed journals passed from Plaintiffs to Defendants in the United States. But this does not change the Court's analysis. Before title passed to Defendants, Plaintiffs did not have possession of the journals, but they did have a right to sue Defendants to recover. (i) the journals themselves or (ii) damages from Defendants' use of the journals (in derogation of Plaintiffs' title). After title passed to Defendants, Plaintiffs were in exactly the same position: Plaintiffs did not have possession of the journals, but they did have a right to sue Defendants to recover the journals or damages from Defendants' use of the journals (in derogation of the contractual promise that the journals were for "valid personal use"). As the change of title made no practical difference to Plaintiffs, the Court believes that Plaintiffs were injured when they lost possession of the journals, rather than when they lost title to the journals.

10 Because the Court has resolved the questions on the jury's verdict form, it need not consider Plaintiffs' alternative argument that the questions on the Court's verdict form should be characterized as general verdict questions, rather than special verdict questions, and that inconsistency between general verdicts does not ordinarily require retrial. (*See* Pl. Supp. Br. 19–20 (citing

Cash v. County of Erie, 654 F.3d 324, 343 (2d Cir. 2011))). However, the Court believes that this argument has considerable force.

End of Document

TAB 73

309 B.R. 679
United States District Court,
S.D. New York.

In re Paolo GUCCI, et al., Debtors.
Frank G. Sinatra, etc., Plaintiff–Appellee,
v.
Alessandra Gucci, at ano., Defendants–Appellants.

No. 03 Civ. 4484(LAK).
|
Adversary No. 00–2373A(CB).
|
Bankruptcy No. 94 B 40614(CB).
|
May 7, 2004.

Synopsis
Background: Chapter 11 trustee of estate of debtor sought declaration that registration of judgment lien in estate property in Rome, Italy was void ab initio. The United States Bankruptcy Court for the Southern District of New York granted judgment for trustee, and appeal was taken.

Holdings: The District, Kaplan, J., held that:

[1] bankruptcy court had in rem jurisdiction over store, which was located in Rome, Italy, of retailer, as Chapter 11 debtor;

[2] *Rooker–Feldman* doctrine was not implicated by bankruptcy court's exercise of in rem jurisdiction over store of retailer;

[3] principle of comity was not implicated by bankruptcy court's exercise of in rem subject matter jurisdiction over store of retailer;

[4] bankruptcy court did not abuse its discretion by declining to abstain and declaring that registration of judgment lien against Chapter 11 debtor in estate property in Rome, Italy was void ab initio; and

[5] opinion of bankruptcy court, which implicitly rejected laches defense, was not sufficient to permit meaningful appellate review.

Vacated and remanded.

Attorneys and Law Firms

***681** Michael S. Devorkin, Golenbock, Eiseman, Assor, Bell & Peskoe, New York City, for Plaintiff–Appellee.

Norris D. Wolff, Edward P. Grosz, Kleinberg, Kaplan, Wolff & Cohen, P.C., New York City, for Defendants–Appellants.

MEMORANDUM OPINION

KAPLAN, District Judge.

This is an appeal from a judgment of the Bankruptcy Court in favor of plaintiff-appellee, the chapter 11 trustee of the estate of Paolo Gucci, declaring void *ab initio* the registration of a judgment lien in estate property (the Gucci Rome store) in Rome, Italy. The lien was registered pursuant to a decision of an Italian court after the automatic stay was in effect, which lien was based on a Swiss arbitration award obtained by defendants against the debtor after the stay came into effect.

Defendants contend that the court below erred in the following respects:

1. Under the *Rooker–Feldman* doctrine and principles of international comity, it should not have exercised subject matter jurisdiction to declare the Italian registration of the Italian lien void *ab initio.* Such relief, they claim, could be granted only by an Italian court.

2. It should not have applied the automatic stay of 11 U.S.C. § 362(a) because either (a) the debtor's concealment of his interest in the property, the Swiss arbitration award, and the Italian lien, or (b) the trustee's failure to commence this adversary proceeding until well after both his discovery of the Swiss proceeding and the Italian lien and the distribution of the bulk of the assets of the estate rendered its enforcement inequitable.

3. The debtor's concealment and/or the trustee's delay, coupled with alleged detrimental reliance, established a defense of laches.

They seek reversal of the judgment and dismissal of the adversary proceeding. As this appeal may be resolved on the basis of legal issues, no recapitulation of the tortuous history of this matter and of the relationships among the parties is necessary.

I. Jurisdiction

[1] Section 1334(e) of the Judicial Code confers on the district court in which a bankruptcy proceeding is pending "exclusive jurisdiction of all of the property, *wherever located,* of the debtor as of the commencement of such case, and of property of the estate." [1] The Gucci Rome store concededly was an asset of the bankrupt estate. The Bankruptcy Court therefore had *in rem* jurisdiction over the Gucci Rome store pursuant to 28 U.S.C. § 157(a) and the Standing Order of Referral of ***682** Cases to Bankruptcy Judges, dated July 10, 1984.

[2] Defendants' contention that the *Rooker–Feldman* doctrine requires a different conclusion because the Bankruptcy Court was asked to review the judgment of an Italian court is without merit. This is so regardless of whether defendants' characterization of the Bankruptcy's Court's action is correct.

[3] The *Rooker–Feldman* doctrine embodies the principle that "among federal courts, only the Supreme Court has subject matter jurisdiction to review state court judgments." [2] Thus, a federal district court lacks jurisdiction over any claim that "directly challenges, or is 'inextricably intertwined' with, a prior state court decision." [3] But defendants have cited no authority for the proposition that *Rooker–Feldman*, whatever its precise reach, [4] applies with respect to foreign court decisions, and this Court has found none. Nor is that surprising. *Rooker–Feldman* is rooted in the structure of our own judicial system, chiefly the fact that federal court review of state court decisions may be had only in the United States Supreme Court. [5] And even if the *Rooker–Feldman* doctrine did apply, in appropriate circumstances, to preclude federal court review of the judgments of foreign courts, it would not apply here in light of Congress' affirmative grant to the district courts of exclusive jurisdiction over estate property. [6]

[4] **[5]** The defendants' comity argument, insofar as it is made as a challenge to subject matter jurisdiction, is no better. "[T]he principle of comity does not limit the legislature's power and is, in the final analysis, simply a rule of construction, it has no application where Congress has indicated otherwise." [7] Thus, whatever the merits of the contention that the court below should have deferred to the judgment of the Italian court as a matter of comity, it has nothing to do with its power to decide the case, its subject matter jurisdiction.

II. Abstention

[6] Defendants appear to argue that the Bankruptcy Court should have abstained here even if it had subject matter jurisdiction. As they intermingle their *Rooker–Feldman* contention with the abstention argument, however, it is difficult to understand precisely what the comity contention is once the *Rooker–Feldman* point is stripped away. As nearly as the Court understands it, the claim seems to be that it was wrong for the Bankruptcy Court to determine that an act of an Italian court was void *ab initio* and, in any case, that any proceeding affecting title to the Gucci Rome store could be brought only in Italy.

"Comity" refers to "a rather nebulous set of principles that may be applicable whenever a court's decision will have ramifications ***683** beyond its territorial jurisdiction and into that of another nation." [8] In the most closely analogous context, it refers to "principles that guide ... courts when deciding whether to abstain from exercising jurisdiction out of deference to parallel proceedings pending in other countries—what Justice Scalia has termed the 'comity of courts.' " [9]

[7] As noted above, the Bankruptcy Court indisputably had *in rem* jurisdiction over the Gucci Rome store. Like all federal courts, it had a "virtually unflagging obligation ... to exercise the jurisdiction given" it. [10] Nevertheless, "federal courts have the inherent, discretionary power to abstain from exercising that jurisdiction in order to extend comity" to foreign proceedings. [11] The question therefore is whether it abused its discretion in declining to abstain from exercising that jurisdiction in deference to the Italian decision granting the judgment lien, some undefined future action in the Italian courts with respect to ownership of the Gucci Rome store, or both. [12]

To begin with, Section 1334(e) of the Judicial Code cuts strongly in favor of the exercise of jurisdiction. It embodies a Congressional determination that bankruptcy courts should determine rights in property of bankrupt estates regardless of where that property may be found. Thus, the Bankruptcy Court's entry of a decree that had a bearing on title to Italian real estate was entirely consistent with the Congressional purpose.

[8] Second, this is not a situation in which there is any necessary or, indeed, likely conflict between the Bankruptcy Court and the courts of Italy. Contrary to defendants' repeated statements, the court below did not declare the act of an Italian court void *ab initio.* It declared void *ab initio*—obviously as a matter of United States law only—the *registration* of the Italian judgment lien. Moreover, the Bankruptcy Court neither purported to alter, nor could have altered, ownership interests in the Italian real estate in the same sense as in cases in which the property is within the physical power or territorial jurisdiction of an *in rem* court. The fact that Congress granted the district courts, and via their referral, the bankruptcy courts power to enter orders affecting assets of the debtor, wherever located, does not preclude foreign courts from exercising jurisdiction over estate property located in their countries, a matter that raises such questions as the extraterritorial effect of the automatic stay and the personal jurisdiction of the United States courts over the entity at whose behest the foreign court acts.[13] As a leading treatise put it:

> "the extraterritorial jurisdiction of the United States courts for these purposes is *in personam* rather than *in rem.* If a creditor causes property of a title 11 estate to be seized in a foreign country, ***684** that creditor has violated the automatic stay. Whether that creditor can be punished, however, is a function of that creditor's amenability to United States process. By the same token, a United States court cannot control the action of the foreign court irrespective of section 1334(e). As one court put it, 'the bankruptcy court is precluded from exercising control over property of the estate located in a foreign country without the assistance of the foreign courts.' " *Id.* at 3–33 (footnote omitted) (quoting *In re Administrative Servs., Inc.,* 211 B.R. 88, 93 (Bankr.M.D.Fla.1997)).
>
> As the property in question here is located in Rome, its fate ultimately will be determined by Italian courts, which will give such weight as they think appropriate to the decision below.[14]

[9] Finally, it bears noting that the "strict duty [of federal courts] to exercise the jurisdiction that is conferred upon them by Congress"[15] is sufficiently strong that abstention normally is denied even where there are parallel proceedings pending in a foreign court[16]—that is, even where the claims at issue before the U.S. court are also before a foreign court. And this case is a far weaker one for abstention, as there is no parallel proceeding in Italy. Rather, there is an already completed Italian case, the judgment in which is not said to be *res judicata* here, and the possibility of some future Italian litigation in which the special considerations applicable in the bankruptcy context presumably would not apply.

In all the circumstances, there is no substantial basis for defendants' contention that the court below abused its discretion by declining to abstain.

III. Laches

[10] Even assuming the Bankruptcy Court properly exercised its jurisdiction over the case below, defendants assert that it should have denied relief and refused to apply the automatic stay on the ground of laches, contending that:

- The debtor concealed his interest in the Gucci Rome store, the Swiss arbitration proceeding and award, the Swiss court order confirming the award, and the Italian court order domesticating the Swiss judgment in Italy in the bankruptcy case and did not raise the U.S. bankruptcy as a defense in those proceedings, thus concealing from the defendants and their predecessor-in-interest information that otherwise might have suggested that a claim later might be asserted that any relief they might obtain in the foreign proceedings might be avoided by a claim that those proceedings violated the automatic stay.

- The trustee knew of the foreign proceedings years ago but delayed assertion of any claim that they violated the automatic stay until after the ***685** bulk of the estate's assets were distributed.

- Defendants were prejudiced in that (a) their predecessor pursued the foreign proceedings, presumably at some expense, which he might not have done had he been aware of the U.S. bankruptcy and the risk that the result of those proceedings might be nullified as violative of the automatic stay, and (b) they no longer can obtain any substantial distribution from the asset because its assets were largely distributed during these delays.

Plaintiff, moreover, assumed that laches or some related equitable defense, if established, would be sufficient in law to preclude relief.[17] He contended, however, that defendants could not,[18] and did not prove facts constituting such a defense.[19]

By granting plaintiff the relief he sought, the court below implicitly rejected the laches defense. Although it received proposed findings of fact and conclusions of law from the parties, however, its opinion contains no findings or conclusions with respect to the laches defense. This Court thus has no way of knowing whether and to what extent the defense or elements thereof were rejected as a matter of law, the reasons for any such rejection, and what factual findings underlay the decision.

[11] Fed.R.Civ.P. 52(a), which applied below by virtue of Bankr.R. 7052, provides in relevant part:

> "In all actions tried upon the facts without a jury, ... the court shall find the facts specially and state separately its conclusions of law thereon...."

This does not necessarily require great detail or adherence to any rigid form. "The court need only make brief, definite, and pertinent findings and conclusions upon contested matters."[20] But "[t]he findings and conclusions must ... at least be sufficient to permit meaningful appellate review."[21]

In this case, the lack of findings and conclusions on the laches issue leave this Court unable properly to review the judgment appealed from. The legal standard applied in determining the existence of laches is unstated as are the lower court's conclusions as to what knowledge was chargeable to which persons as a matter of law. Likewise unstated are the inferences it drew from otherwise undisputed facts and, perhaps most important, its findings as to the states of mind of the various players at various times.

In the circumstances, the appropriate course is to vacate and remand.[22]

Conclusion

For the foregoing reasons, the judgment of the Bankruptcy Court is vacated and ***686** the case remanded for the purpose of making findings of fact and conclusions of law with respect to the equitable defense previously advanced by the defendants.

SO ORDERED.

All Citations

309 B.R. 679, 43 Bankr.Ct.Dec. 5

Footnotes

[1] 28 U.S.C. § 1334(e) (emphasis added).

[2] *Johnson v. Smithsonian Inst.,* 189 F.3d 180, 185 (2d Cir.1999) (citing *District of Columbia Court of Appeals v. Feldman,* 460 U.S. 462, 103 S.Ct. 1303, 75 L.Ed.2d 206 (1983)); *Rooker v. Fidelity Trust Co.,* 263 U.S. 413, 44 S.Ct. 149, 68 L.Ed. 362 (1923); *Hachamovitch v. DeBuono,* 159 F.3d 687, 693–94 (2d Cir.1998).

[3] *Karamoko v. New York City Housing Auth.,* 170 F.Supp.2d 372, 376 (S.D.N.Y.2001).

[4] *See, e.g., Latino Officers Ass'n v. City of New York,* 253 F.Supp.2d 771, 778–80 (S.D.N.Y.2003).

[5] *Feldman,* 460 U.S. at 476, 103 S.Ct. 1303.

[6] *E.g., Huse v. Huse–Sporsem, A.S.,* 300 B.R. 489, 498 (9th Cir. BAP 2003) (citing cases).

[7] *Maxwell Comm. Corp. v. Societe Generale,* 93 F.3d 1036, 1047 (2d Cir.1996).

[8] *Turner Entertainment Co. v. Degeto Film GmbH,* 25 F.3d 1512, 1519 n. 10 (11th Cir.1994).

[9] *United Feature Syndicate, Inc. v. Miller Features Syndicate, Inc.,* 216 F.Supp.2d 198, 210 (S.D.N.Y.2002) (quoting *Hartford Fire Ins. Co. v. California,* 509 U.S. 764, 817–18 n. 9, 113 S.Ct. 2891, 125 L.Ed.2d 612 (1993) (Scalia, J., dissenting)).

[10] *Colorado River Water Conserv. Dist. v. United States,* 424 U.S. 800, 817, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976).

[11] *United Feature Syndicate, Inc.,* 216 F.Supp.2d at 210.

[12] *See id.* at 212.

[13] 1 KING, ET AL., COLLIER ON BANKRUPTCY ¶ 3.01[5], at 3–32 to 3–33 (15th ed. rev.2003).

[14] In doing so, the Italian courts may well take into account the fundamentally different objectives served by the bankruptcy litigation here and the prior litigation in Italy. In this case, the Bankruptcy Court was concerned with marshaling the assets of the debtor's estate for the benefit of creditors. It appears that the concern of the Italian court was purely with the question whether a Swiss arbitration award, entered in a dispute between the debtor and the defendants' predecessor-in-interest, should be domesticated in Italy.

[15] *Quackenbush v. Allstate Ins. Co.,* 517 U.S. 706, 716, 116 S.Ct. 1712, 135 L.Ed.2d 1 (1996).

[16] *See China Trade & Development Corp. v. M.V. Choong Yong,* 837 F.2d 33, 36 (2d Cir.1987).

[17] *See* Joint Pretrial Order § (8), Plaintiff's Contentions of Law, ¶ 1(c), at 17.

[18] *Id.* § (6).

[19] *See* Plaintiff's Proposed Findings of Fact and Conclusions of Law, *passim.*

In certain respects, the plaintiff's position rests on legal contentions. For example, he argued that defendants' predecessor-in-interest was chargeable with constructive notice of the bankruptcy petition and that the debtor's knowledge and actions could be imputed to plaintiff as trustee of the estate. In other respects, however, it depended upon factual contentions such as whether defendants' predecessor-in-interest had actual knowledge of the petition and when defendants themselves learned of various events.

[20] 9A CHARLES ALAN WRIGHT AND ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE: CIVIL 2D § 2579, at 541 (1995).

[21] *In re Mazzeo,* 167 F.3d 139, 142 (2d Cir.1999).

[22] *Id.*

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TAB 74

130 S.Ct. 1181
Supreme Court of the United States

The HERTZ CORP., Petitioner,
v.
Melinda FRIEND et al.

No. 08–1107.
|
Argued Nov. 10, 2009.
|
Decided Feb. 23, 2010.

Synopsis
Background: Plaintiffs, on behalf of a potential class of California citizens, brought action in state court against corporation alleging violations of California's wage and hour laws. Following removal under the Class Action Fairness Act (CAFA), the United States District Court for the Northern District of California, Maxine M. Chesney, J., granted plaintiffs' motion to remand. Corporation appealed. The United States Court of Appeals for the Ninth Circuit, 297 Fed.Appx. 690, affirmed. Certiorari was granted.

Holdings: The Supreme Court, Justice Breyer, held that:

[1] Supreme Court had jurisdiction to review the case;

[2] corporation's principal place of business, for diversity jurisdiction purposes, is its nerve center, abrogating *Diaz–Rodriguez v. Pep Boys Corp.*, 410 F.3d 56, *Capitol Indemnity Corp. v. Russellville Steel Co.,* 367 F.3d 831, *Tosco Corp. v. Communities for a Better Environment,* 236 F.3d 495, *Amoco Rocmount Co. v. Anschutz Corp.,* 7 F.3d 909, *Gafford v. General Elec. Co.,* 997 F.2d 150, *R.G. Barry Corp. v. Mushroom Makers, Inc.,* 612 F.2d 651, *Continental Coal Corp. v. Roszelle Bros.,* 242 F. 243; and

[3] remand was warranted to give plaintiffs opportunity to litigate their case in light of the Court's holding.

Vacated and remanded.

****1183 *77** *Syllabus* [*]

Respondents, California citizens, sued petitioner Hertz Corporation in a California state court for claimed state-law violations. Hertz sought removal to the Federal District Court under 28 U.S.C. §§ 1332(d)(2), 1441(a), claiming that because it and respondents were citizens of different States, §§ 1332(a)(1), (c)(1), the federal court possessed diversity-of-citizenship jurisdiction. Respondents, however, claimed that Hertz was a California citizen, like themselves, and that, hence, diversity jurisdiction was lacking under § 1332(c)(1), which provides that "a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business." To show that its "principal place of business" was in New Jersey, not California, Hertz submitted a declaration stating, among other things, that it operated facilities in 44 States, that California accounted for only a portion of its business activity, that its leadership is at its corporate headquarters in New Jersey, and that its core executive and administrative functions are primarily carried out there. The District Court concluded that it lacked diversity jurisdiction because Hertz was a California citizen under Ninth Circuit precedent, which asks, *inter alia,* whether the amount of the corporation's business activity is “significantly larger” or “substantially predominates” in one State. Finding that California was Hertz's “principal place of business” under that test because a plurality of the relevant business activity occurred there, the District Court remanded the case to state court. The Ninth Circuit affirmed.

Held:

1. Respondents' argument that this Court lacks jurisdiction under § 1453(c)—which expressly permits appeals of remand orders such as the District Court's only to “court[s] of appeals,” not to the Supreme Court, and provides that if “a final judgment on the appeal” in a court of appeals “is not issued before the end” of 60 days (with a possible 10–day extension), “the appeal shall be denied”—makes far too much of too little. The Court normally does not read statutory silence as implicitly modifying or limiting its jurisdiction that another statute specifically grants. *E.g., Felker v. Turpin,* 518 U.S. 651, 660–661, 116 S.Ct. 2333, 135 L.Ed.2d 827. Here, replicating similar, older statutes, § 1254 specifically gives the Court jurisdiction to “revie [w] ... [b]y writ of certiorari” cases that are “in the courts of ***78** appeals” when it grants the writ. The Court thus interprets § 1453 (c)'s “60–day” requirement as simply requiring a court of appeals to reach a decision within a specified time—not to deprive this Court of subsequent jurisdiction to review the case. See, *e.g., Aetna Casualty & Surety Co. v. Flowers,* 330 U.S. 464, 466–467, 67 S.Ct. 798, 91 L.Ed. 1024. P. 1187.

2. The phrase “principal place of business” in § 1332(c)(1) refers to the place where a corporation's high level officers direct, control, and coordinate the corporation's activities, *i.e.,* its “nerve center,” which will typically be found at its corporate headquarters. Pp. 1187 – 1195.

(a) A brief review of the legislative history of diversity jurisdiction demonstrates that Congress added § 1332(c)(1)'s “principal place of business” language to ****1184** the traditional state-of-incorporation test in order to prevent corporations from manipulating federal-court jurisdiction as well as to reduce the number of diversity cases. Pp. 1187 – 1190.

(b) However, the phrase “principal place of business” has proved more difficult to apply than its originators likely expected. After Congress' amendment, courts were uncertain as to where to look to determine a corporation's “principal place of business” for diversity purposes. If a corporation's headquarters and executive offices were in the same State in which it did most of its business, the test seemed straightforward. The “principal place of business” was in that State. But if those corporate headquarters, including executive offices, were in one State, while the corporation's plants or other centers of business activity were located in other States, the answer was less obvious. Under these circumstances, for corporations with “far-flung” business activities, numerous Circuits have looked to a corporation's “nerve center,” from which the corporation radiates out to its constituent parts and from which its officers direct, control, and coordinate the corporation's activities. However, this test did not go far enough, for it did not answer what courts should do when a corporation's operations are not far-flung but rather limited to only a few States. When faced with this question, various courts have focused more heavily on where a corporation's actual business activities are located, adopting divergent and increasingly complex tests to interpret the statute. Pp. 1190 – 1192.

(c) In an effort to find a single, more uniform interpretation of the statutory phrase, this Court returns to the “nerve center” approach: “[P]rincipal place of business” is best read as referring to the place where a corporation's officers direct, control, and coordinate the corporation's activities. In practice it should normally be the place where the corporation maintains its headquarters—provided that the headquarters is the actual center of direction, control, and coordination, *i.e.,* the “nerve center,” and not simply an office where the corporation holds its board meetings. Pp. 1192 – 1195.

***79** (i) Three sets of considerations, taken together, convince the Court that the “nerve center” approach, while imperfect, is superior to other possibilities. First, § 1332(c)(1)'s language supports the approach. The statute's word "place" is singular, not plural. Its word "principal" requires that the main, prominent, or most important place be chosen. Cf., *e.g., Commissioner v. Soliman,* 506 U.S. 168, 174, 113 S.Ct. 701, 121 L.Ed.2d 634. And the fact that the word "place" follows the words "State where" means that the "place" is a place *within* a State, not the State itself. A corporation's "nerve center," usually its main headquarters, is a single place. The public often considers it the corporation's main place of business. And it is a place within a State. By contrast, the application of a more general business activities test has led some courts, as in the present case, to look, not at a particular place within a State, but incorrectly at the State itself, measuring the total amount of business activities that the corporation conducts there and determining whether they are significantly larger than in the next-ranking State. Second, administrative simplicity is a major virtue in a jurisdictional statute. *Sisson v. Ruby,* 497 U.S. 358, 375, 110 S.Ct. 2892, 111 L.Ed.2d 292. A "nerve center" approach, which ordinarily equates that "center" with a corporation's headquarters, is simple to apply *comparatively speaking*. By contrast, a corporation's general business activities more often lack a single principal place where they take place. Third, the statute's legislative history suggests that ****1185** the words "principal place of business" should be interpreted to be no more complex than an earlier, numerical test that was criticized as too complex and impractical to apply. A "nerve center" test offers such a possibility. A general business activities test does not. Pp. 1192 – 1194.

(ii) While there may be no perfect test that satisfies all administrative and purposive criteria, and there will be hard cases under the "nerve center" test adopted today, this test is relatively easier to apply and does not require courts to weigh corporate functions, assets or revenues different in kind, one from the other. And though this test may produce results that seem to cut against the basic rationale of diversity jurisdiction, accepting occasionally counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration while producing the benefits that accompany a more uniform legal system. P. 1194.

(iii) If the record reveals attempts at jurisdictional manipulation—for example, that the alleged "nerve center" is nothing more than a mail drop box, a bare office with a computer, or the location of an annual executive retreat—the courts should instead take as the "nerve center" the place of actual direction, control, and coordination, in the absence of such manipulation. Pp. 1194 – 1195.

***80** (d) Although petitioner's unchallenged declaration suggests that Hertz's "nerve center" and its corporate headquarters are one and the same, and that they are located in New Jersey, not in California, respondents should have a fair opportunity on remand to litigate their case in light of today's holding. P. 1195.

297 Fed.Appx. 690, vacated and remanded.

BREYER, J., delivered the opinion for a unanimous Court.

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Opinion

Justice BREYER delivered the opinion of the Court.

The federal diversity jurisdiction statute provides that "a corporation shall be deemed to be a citizen of any State by which it has been incorporated *and of the State where it has its principal place of business.*" 28 U.S.C. § 1332(c)(1) (emphasis added). We seek here to resolve different interpretations that the Circuits have given this phrase. In doing so, we ****1186** place primary weight upon the need for judicial administration of a jurisdictional statute to remain as simple as possible. And we conclude that the phrase "principal place of business" refers to the place where the corporation's high level officers direct, control, and coordinate the corporation's activities. Lower federal courts have often metaphorically ***81** called that place the corporation's "nerve center." See, *e.g., Wisconsin Knife Works v. National Metal Crafters,* 781 F.2d 1280, 1282 (C.A.7 1986); *Scot Typewriter Co. v. Underwood Corp.,* 170 F.Supp. 862, 865 (S.D.N.Y.1959) (Weinfeld, J.). We believe that the "nerve center" will typically be found at a corporation's headquarters.

I

In September 2007, respondents Melinda Friend and John Nhieu, two California citizens, sued petitioner, the Hertz Corporation, in a California state court. They sought damages for what they claimed were violations of California's wage and hour laws. App. to Pet. for Cert. 20a. And they requested relief on behalf of a potential class composed of California citizens who had allegedly suffered similar harms.

Hertz filed a notice seeking removal to a federal court. 28 U.S.C. §§ 1332(d)(2), 1453. Hertz claimed that the plaintiffs and the defendant were citizens of different States. §§ 1332(a)(1), (c)(1). Hence, the federal court possessed diversity-of-citizenship jurisdiction. Friend and Nhieu, however, claimed that the Hertz Corporation was a California citizen, like themselves, and that, hence, diversity jurisdiction was lacking.

To support its position, Hertz submitted a declaration by an employee relations manager that sought to show that Hertz's "principal place of business" was in New Jersey, not in California. The declaration stated, among other things, that Hertz operated facilities in 44 States; and that California—which had about 12% of the Nation's population, Pet. for Cert. 8—accounted for 273 of Hertz's 1,606 car rental locations; about 2,300 of its 11,230 full-time employees; about $811 million of its $4.371 billion in annual revenue; and about 3.8 million of its approximately 21 million annual transactions, *i.e.,* rentals. The declaration also stated that the "leadership of Hertz and its domestic subsidiaries" is located at Hertz's "corporate headquarters" in Park Ridge, New Jersey; ***82** that its "core executive and administrative functions ... are carried out" there and "to a lesser extent" in Oklahoma City, Oklahoma; and that its "major administrative operations ... are found" at those two locations. App. to Pet. for Cert. 26a–30a.

The District Court of the Northern District of California accepted Hertz's statement of the facts as undisputed. But it concluded that, given those facts, Hertz was a citizen of California. In reaching this conclusion, the court applied Ninth Circuit precedent, which instructs courts to identify a corporation's "principal place of business" by first determining the amount of a corporation's business activity State by State. If the amount of activity is "significantly larger" or "substantially predominates" in one State, then that State is the corporation's "principal place of business." If there is no such State, then the "principal place of business" is the corporation's " 'nerve center,' " *i.e.,* the place where " 'the majority of its executive and administrative functions are performed.' " *Friend v. Hertz,* No. C–07–5222 MMC, 2008 WL 7071465 (N.D.Cal., Jan. 15, 2008), p. 3 (hereinafter Order); *Tosco Corp. v. Communities for a Better Environment,* 236 F.3d 495, 500–502 (C.A.9 2001) *(per curiam).*

****1187** Applying this test, the District Court found that the "plurality of each of the relevant business activities" was in California, and that "the differential between the amount of those activities" in California and the amount in "the next closest state" was "significant." Order 4. Hence, Hertz's "principal place of business" was California, and diversity jurisdiction was thus lacking. The District Court consequently remanded the case to the state courts.

Hertz appealed the District Court's remand order. 28 U.S.C. § 1453(c). The Ninth Circuit affirmed in a brief memorandum opinion. 297 Fed.Appx. 690 (2008). Hertz filed a petition for certiorari. And, in light of differences among the Circuits in the application of the test for corporate citizenship, we granted the writ. Compare *Tosco Corp.,* ***83** *supra,* at 500–502, and *Capitol Indemnity Corp. v. Russellville Steel Co.,* 367 F.3d 831, 836 (C.A.8 2004) (applying "total activity" test and looking at "all corporate activities"), with *Wisconsin Knife Works, supra,* at 1282 (applying "nerve center" test).

II

[1] At the outset, we consider a jurisdictional objection. Respondents point out that the statute permitting Hertz to appeal the District Court's remand order to the Court of Appeals, 28 U.S.C. § 1453(c), constitutes an exception to a more general jurisdictional rule that remand orders are "not reviewable on appeal." § 1447(d). They add that the language of § 1453(c) refers only to "court[s] of appeals," not to the Supreme Court. The statute also says that if "a final judgment on the appeal" in a court of appeals "is not issued before the end" of 60 days (with a possible 10–day extension), "the appeal shall be denied." And respondents draw from these statutory circumstances the conclusion that Congress intended to permit review of a remand order only by a court of appeals, not by the Supreme Court (at least not if, as here, this Court's grant of certiorari comes after § 1453(c)'s time period has elapsed).

[2] This argument, however, makes far too much of too little. We normally do not read statutory silence as implicitly modifying or limiting Supreme Court jurisdiction that another statute specifically grants. *Felker v. Turpin,* 518 U.S. 651, 660–661, 116 S.Ct. 2333, 135 L.Ed.2d 827 (1996); *Ex parte Yerger,* 8 Wall. 85, 104–105, 19 L.Ed. 332 (1869). Here, another, pre-existing federal statute gives this Court jurisdiction to "revie[w] ... [b]y writ of certiorari" cases that, like this case, are "in the courts of appeals" when we grant the writ. 28 U.S.C. § 1254. This statutory jurisdictional grant replicates similar grants that yet older statutes provided. See, *e.g.,* § 1254, 62 Stat. 928; § 1, 43 Stat. 938–939 (amending § 240, 36 Stat. 1157); § 240, 36 Stat. 1157; Evarts Act, § 6, 26 Stat. 828. This history provides particularly strong reasons *not* to read § 1453(c)'s silence or ambiguous ***84** language as modifying or limiting our pre-existing jurisdiction.

We thus interpret § 1453(c)'s "60–day" requirement as simply requiring a court of appeals to reach a decision within a specified time—not to deprive this Court of subsequent jurisdiction to review the case. See *Aetna Casualty & Surety Co. v. Flowers,* 330 U.S. 464, 466–467, 67 S.Ct. 798, 91 L.Ed. 1024 (1947); *Gay v. Ruff,* 292 U.S. 25, 28–31, 54 S.Ct. 608, 78 L.Ed. 1099 (1934).

III

[3] We begin our "principal place of business" discussion with a brief review of relevant history. The Constitution provides that the "judicial Power shall extend" to "Controversies ... between Citizens of different States." Art. III, § 2. This language, however, does not automatically ****1188** confer diversity jurisdiction upon the federal courts. Rather, it authorizes Congress to do so and, in doing so, to determine the scope of the federal courts' jurisdiction within constitutional limits. *Kline v. Burke Constr. Co.,* 260 U.S. 226, 233–234, 43 S.Ct. 79, 67 L.Ed. 226 (1922); *Mayor v. Cooper,* 6 Wall. 247, 252, 18 L.Ed. 851 (1868).

Congress first authorized federal courts to exercise diversity jurisdiction in 1789 when, in the First Judiciary Act, Congress granted federal courts authority to hear suits "between a citizen of the State where the suit is brought, and a citizen of another State." § 11, 1 Stat. 78. The statute said nothing about corporations. In 1809, Chief Justice Marshall, writing for a unanimous Court, described a corporation as an "invisible, intangible, and artificial being" which was "certainly not a citizen." *Bank of United States v. Deveaux,* 5 Cranch 61, 86, 3 L.Ed. 38 (1809). But the Court held that a corporation could invoke the federal courts' diversity jurisdiction based on a pleading that the corporation's shareholders were all citizens of a different State from the defendants, as "the term citizen ought to be understood as it is used in the constitution, and as it is used in other laws. That is, to describe the real ***85** persons who come into court, in this case, under their corporate name." *Id.,* at 91–92.

In *Louisville, C. & C.R. Co. v. Letson,* 2 How. 497, 11 L.Ed. 353 (1844), the Court modified this initial approach. It held that a corporation was to be deemed an artificial person of the State by which it had been created, and its citizenship for jurisdictional purposes determined accordingly. *Id.,* at 558–559. Ten years later, the Court in *Marshall v. Baltimore & Ohio R. Co.,* 16 How. 314, 14 L.Ed. 953 (1854), held that the reason a corporation was a citizen of its State of incorporation was that, for the limited purpose of determining corporate citizenship, courts could conclusively (and artificially) presume that a corporation's *shareholders* were citizens of the State of incorporation. *Id.,* at 327–328. And it reaffirmed *Letson.* 16 How., at 325–326, 14 L.Ed. 953. Whatever the rationale, the practical upshot was that, for diversity purposes, the federal courts considered a corporation to be a citizen of the State of its incorporation. 13F C. Wright, A. Miller, & E. Cooper, Federal Practice and Procedure § 3623, pp. 1–7 (3d ed. 2009) (hereinafter Wright & Miller).

In 1928 this Court made clear that the "state of incorporation" rule was virtually absolute. It held that a corporation closely identified with State A could proceed in a federal court located in that State as long as the corporation had filed its incorporation papers in State B, perhaps a State where the corporation did no business at all. See *Black and White Taxicab & Transfer Co. v. Brown and Yellow Taxicab & Transfer Co.,* 276 U.S. 518, 522–525, 48 S.Ct. 404, 72 L.Ed. 681 (refusing to question corporation's reincorporation motives and finding diversity jurisdiction). Subsequently, many in Congress and those who testified before it pointed out that this interpretation was at odds with diversity jurisdiction's basic rationale, namely, opening the federal courts' doors to those who might otherwise suffer from local prejudice against out-of-state parties. See, *e.g.,* S.Rep. No. 530, 72d Cong., 1st Sess., 2, 4–7 (1932). Through its choice of the State of incorporation, ***86** a corporation could manipulate federal-court jurisdiction, for example, opening the federal courts' doors in a State where it conducted nearly all its business by filing incorporation papers elsewhere. *Id.,* at 4 ("Since the Supreme Court has decided that a corporation is a citizen ... it has become a common practice for corporations to be incorporated in one State while they do business in another. And there is no doubt but that it often occurs ****1189** simply for the purpose of being able to have the advantage of choosing between two tribunals in case of litigation"). See also Hearings on S. 937 et al. before a Subcommittee of the Senate Committee on the Judiciary, 72d Cong., 1st Sess., 4–5 (1932) (Letter from Sen. George W. Norris to Attorney General William D. Mitchell (May 24, 1930)) (citing a "common practice for individuals to incorporate in a foreign State simply for the purpose of taking litigation which may arise into the Federal courts"). Although various legislative proposals to curtail the corporate use of diversity jurisdiction were made, see, *e.g.,* S. 937, S. 939, H.R. 11508, 72d Cong., 1st Sess. (1932), none of these proposals were enacted into law.

At the same time as federal dockets increased in size, many judges began to believe those dockets contained too many diversity cases. A committee of the Judicial Conference of the United States studied the matter. See Reports of the Proceedings of the Regular Annual Meeting and Special Meeting (Sept. 24–26 & Mar. 19–20, 1951), in H.R. Doc. No. 365, 82d Cong., 2d Sess., pp. 26–27 (1952). And on March 12, 1951, that committee, the Committee on Jurisdiction and Venue, issued a report (hereinafter Mar. Committee Rept.).

Among its observations, the committee found a general need "to prevent frauds and abuses" with respect to jurisdiction. *Id.,* at 14. The committee recommended against eliminating diversity cases altogether. *Id.,* at 28. Instead it recommended, along with other proposals, a statutory amendment that would make a corporation a citizen both of the State of its incorporation and any State from which it ***87** received more than half of its gross income. *Id.,* at 14–15 (requiring corporation to show that "less than fifty per cent of its gross income was derived from business transacted within the state where the Federal court is held"). If, for example, a citizen of California sued (under state law in state court) a corporation that received half or more of its gross income from California, that corporation would not be able to remove the case to federal court, even if Delaware was its State of incorporation.

During the spring and summer of 1951 committee members circulated their report and attended circuit conferences at which federal judges discussed the report's recommendations. Reflecting those criticisms, the committee filed a new report in September, in which it revised its corporate citizenship recommendation. It now proposed that " 'a corporation shall be deemed a citizen of the state of its original creation ... [and] shall also be deemed a citizen of a state where it has its principal place of business.' " Judicial Conference of the United States, Report of the Committee on Jurisdiction and Venue 4 (Sept. 24, 1951) (hereinafter Sept. Committee Rept.)—the source of the present-day statutory language. See Hearings on H.R. 2516 et al. before Subcommittee No. 3 of the House Committee on the Judiciary, 85th Cong., 1st Sess., 9 (1957) (hereinafter House Hearings). The committee wrote that this new language would provide a "simpler and more practical formula" than the "gross income" test. Sept. Committee Rept. 2. It added that the language "ha[d] a precedent in the jurisdictional provisions of the Bankruptcy Act." *Id.*, at 2–3.

In mid–1957 the committee presented its reports to the House of Representatives Committee on the Judiciary. House Hearings 9–27; see also H. Rep. No. 1706, 85th Cong., 2d Sess., 27–28 (1958) (hereinafter H.R. Rep. 1706) (reprinting Mar. and Sept. Committee Repts.); S.Rep. No. 1830, 85th Cong., 2d Sess., 15–31 (1958) (hereinafter S. Rep. 1830) (same). Judge Albert Maris, ****1190** representing ***88** Judge John Parker (who had chaired the Judicial Conference Committee), discussed various proposals that the Judicial Conference had made to restrict the scope of diversity jurisdiction. In respect to the "principal place of business" proposal, he said that the relevant language "ha[d] been defined in the Bankruptcy Act." House Hearings 37. He added:

> "All of those problems have arisen in bankruptcy cases, and as I recall the cases—and I wouldn't want to be bound by this statement because I haven't them before me—I think the courts have generally taken the view that where a corporation's interests are rather widespread, the principal place of business is an actual rather than a theoretical or legal one. It is the actual place where its business operations are coordinated, directed, and carried out, which would ordinarily be the place where its officers carry on its day-to-day business, where its accounts are kept, where its payments are made, and not necessarily a State in which it may have a plant, if it is a big corporation, or something of that sort."
>
> "But that has been pretty well worked out in the bankruptcy cases, and that law would all be available, you see, to be applied here without having to go over it again from the beginning." *Ibid.*

The House Committee reprinted the Judicial Conference Committee Reports along with other reports and relevant testimony and circulated it to the general public "for the purpose of inviting further suggestions and comments." *Id.,* at III. Subsequently, in 1958, Congress both codified the courts' traditional place of incorporation test and also enacted into law a slightly modified version of the Conference Committee's proposed "principal place of business" language. A corporation was to "be deemed a citizen of any State by which it has been incorporated and of the State where it has its principal place of business." § 2, 72 Stat. 415.

***89** IV

The phrase "principal place of business" has proved more difficult to apply than its originators likely expected. Decisions under the Bankruptcy Act did not provide the firm guidance for which Judge Maris had hoped because courts interpreting bankruptcy law did not agree about how to determine a corporation's "principal place of business." Compare *Burdick v. Dillon,* 144 F. 737, 738 (C.A.1 1906) (holding that a corporation's "principal office, rather than a factory, mill, or mine ... constitutes the 'principal place of business' "), with *Continental Coal Corp. v. Roszelle Bros.,* 242 F. 243, 247

(C.A.6 1917) (identifying the "principal place of business" as the location of mining activities, rather than the "principal office"); see also Friedenthal, New Limitations on Federal Jurisdiction, 11 Stan. L.Rev. 213, 223 (1959) ("The cases under the Bankruptcy Act provide no rigid legal formula for the determination of the principal place of business").

After Congress' amendment, courts were similarly uncertain as to where to look to determine a corporation's "principal place of business" for diversity purposes. If a corporation's headquarters and executive offices were in the same State in which it did most of its business, the test seemed straightforward. The "principal place of business" was located in that State. See, *e.g., Long v. Silver,* 248 F.3d 309, 314–315 (C.A.4 2001); *Pinnacle Consultants, Ltd. v. Leucadia Nat. Corp.,* 101 F.3d 900, 906–907 (C.A.2 1996).

But suppose those corporate headquarters, including executive offices, are in one State, while the corporation's plants or other centers of business activity are located ****1191** in other States? In 1959 a distinguished federal district judge, Edward Weinfeld, relied on the Second Circuit's interpretation of the Bankruptcy Act to answer this question in part:

> "Where a corporation is engaged in far-flung and varied activities which are carried on in different states, its ***90** principal place of business is the nerve center from which it radiates out to its constituent parts and from which its officers direct, control and coordinate all activities without regard to locale, in the furtherance of the corporate objective. The test applied by our Court of Appeals, is that place where the corporation has an 'office from which its business was directed and controlled'—the place where 'all of its business was under the supreme direction and control of its officers.' " *Scot Typewriter Co.,* 170 F.Supp., at 865.

Numerous Circuits have since followed this rule, applying the "nerve center" test for corporations with "far-flung" business activities. See, *e.g., Topp v. CompAir Inc.,* 814 F.2d 830, 834 (C.A.1 1987); see also 15 J. Moore et al., Moore's Federal Practice § 102.54[2], p. 102–112.1 (3d ed. 2009) (hereinafter Moore's).

Scot's analysis, however, did not go far enough. For it did not answer what courts should do when the operations of the corporation are not "far-flung" but rather limited to only a few States. When faced with this question, various courts have focused more heavily on where a corporation's actual business activities are located. See, *e.g., Diaz–Rodriguez v. Pep Boys Corp.,* 410 F.3d 56, 60–61 (C.A.1 2005); *R.G. Barry Corp. v. Mushroom Makers, Inc.,* 612 F.2d 651, 656–657 (C.A.2 1979); see also 15 Moore's § 102.54, at 102–112.1.

Perhaps because corporations come in many different forms, involve many different kinds of business activities, and locate offices and plants for different reasons in different ways in different regions, a general "business activities" approach has proved unusually difficult to apply. Courts must decide which factors are more important than others: for example, plant location, sales or servicing centers; transactions, payrolls, or revenue generation. See, *e.g., R.G. Barry Corp., supra,* at 656–657 (place of sales and advertisement, office, and full-time employees); *Diaz–Rodriguez,* ***91** *supra,* at 61–62 (place of stores and inventory, employees, income, and sales).

The number of factors grew as courts explicitly combined aspects of the "nerve center" and "business activity" tests to look to a corporation's "total activities," sometimes to try to determine what treatises have described as the corporation's "center of gravity." See, *e.g., Gafford v. General Elec. Co.,* 997 F.2d 150, 162–163 (C.A.6 1993); *Amoco Rocmount Co. v. Anschutz Corp.,* 7 F.3d 909, 915 (C.A.10 1993); 13F Wright & Miller § 3625, at 100. A major treatise confirms this growing complexity, listing Circuit by Circuit, cases that highlight different factors or emphasize similar factors differently, and reporting that the "federal courts of appeals have employed various tests"—tests which "tend to overlap" and which are sometimes described in "language" that "is imprecise." 15 Moore's § 102.54[2], at 102–112. See also *id.,* §§ 102.54[2], [13], at 102–112 to 102–122 (describing, in 14 pages, major tests as looking to the "nerve center," "locus of operations," or "center of corporate activities"). Not surprisingly, different circuits (and sometimes different courts within a single circuit) have applied these highly general multifactor tests in different ways. *Id.,* §§ 102.54[3]-[7], [11]-[13] (noting that the First Circuit "has never explained a basis for choosing between 'the center of corporate ****1192** activity' test and the 'locus of operations' test"; the Second Circuit uses a "two-part test" similar to that of the Fifth, Ninth, and Eleventh

Circuits involving an initial determination as to whether "a corporation's activities are centralized or decentralized" followed by an application of either the "place of operations" or "nerve center" test; the Third Circuit applies the "center of corporate activities" test searching for the "headquarters of a corporation's day-to-day activity"; the Fourth Circuit has "endorsed neither [the 'nerve center' or 'place of operations'] test to the exclusion of the other"; the Tenth Circuit directs consideration of the "total activity of the company considered as a whole"). See also ***92** 13F Wright & Miller § 3625 (describing, in 73 pages, the "nerve center," " corporate activities," and "total activity" tests as part of an effort to locate the corporation's "center of gravity," while specifying different ways in which different circuits apply these or other factors).

This complexity may reflect an unmediated judicial effort to apply the statutory phrase "principal place of business" in light of the general purpose of diversity jurisdiction, *i.e.,* an effort to find the State where a corporation is least likely to suffer out-of-state prejudice when it is sued in a local court, *Pease v. Peck,* 18 How. 595, 599, 15 L.Ed. 518 (1856). But, if so, that task seems doomed to failure. After all, the relevant purposive concern—prejudice against an out-of-state party—will often depend upon factors that courts cannot easily measure, for example, a corporation's image, its history, and its advertising, while the factors that courts can more easily measure, for example, its office or plant location, its sales, its employment, or the nature of the goods or services it supplies, will sometimes bear no more than a distant relation to the likelihood of prejudice. At the same time, this approach is at war with administrative simplicity. And it has failed to achieve a nationally uniform interpretation of federal law, an unfortunate consequence in a federal legal system.

V

A

[4] In an effort to find a single, more uniform interpretation of the statutory phrase, we have reviewed the Courts of Appeals' divergent and increasingly complex interpretations. Having done so, we now return to, and expand, Judge Weinfeld's approach, as applied in the Seventh Circuit. See, *e.g., Scot Typewriter Co.,* 170 F.Supp., at 865; *Wisconsin Knife Works,* 781 F.2d, at 1282. We conclude that "principal place of business" is best read as referring to the place where a corporation's officers direct, control, and coordinate the corporation's ***93** activities. It is the place that Courts of Appeals have called the corporation's "nerve center." And in practice it should normally be the place where the corporation maintains its headquarters—provided that the headquarters is the actual center of direction, control, and coordination, *i.e.,* the "nerve center," and not simply an office where the corporation holds its board meetings (for example, attended by directors and officers who have traveled there for the occasion).

Three sets of considerations, taken together, convince us that this approach, while imperfect, is superior to other possibilities. First, the statute's language supports the approach. The statute's text deems a corporation a citizen of the "State where it has its principal place of business." 28 U.S.C. § 1332(c)(1). The word "place" is in the singular, not the plural. The word "principal" requires us to pick out the "main, prominent" or "leading" place. 12 Oxford English Dictionary 495 (2d ed. 1989) (def.(A)(I)(2)). Cf. ****1193** *Commissioner v. Soliman,* 506 U.S. 168, 174, 113 S.Ct. 701, 121 L.Ed.2d 634 (1993) (interpreting "principal place of business" for tax purposes to require an assessment of "whether any one business location is the 'most important, consequential, or influential' one"). And the fact that the word "place" follows the words "State where" means that the "place" is a place *within* a State. It is not the State itself.

[5] A corporation's "nerve center," usually its main headquarters, is a single place. The public often (though not always) considers it the corporation's main place of business. And it is a place within a State. By contrast, the application of a more general business activities test has led some courts, as in the present case, to look, not at a particular place within a State, but incorrectly at the State itself, measuring the total amount of business activities that the corporation conducts there and determining whether they are "significantly larger" than in the next-ranking State. 297 Fed.Appx. 690.

***94** This approach invites greater litigation and can lead to strange results, as the Ninth Circuit has since recognized. Namely, if a " corporation may be deemed a citizen of California on th[e] basis" of " activities [that] roughly reflect California's larger population ... nearly every national retailer—no matter how far flung its operations—will be deemed a citizen of California for diversity purposes." *Davis v. HSBC Bank Nev., N. A.,* 557 F.3d 1026, 1029–1030 (2009). But why award or decline diversity jurisdiction on the basis of a State's population, whether measured directly, indirectly (say proportionately), or with modifications?

[6] Second, administrative simplicity is a major virtue in a jurisdictional statute. *Sisson v. Ruby,* 497 U.S. 358, 375, 110 S.Ct. 2892, 111 L.Ed.2d 292 (1990) (SCALIA, J., concurring in judgment) (eschewing "the sort of vague boundary that is to be avoided in the area of subject-matter jurisdiction wherever possible"). Complex jurisdictional tests complicate a case, eating up time and money as the parties litigate, not the merits of their claims, but which court is the right court to decide those claims. Cf. *Navarro Savings Assn. v. Lee,* 446 U.S. 458, 464, n. 13, 100 S.Ct. 1779, 64 L.Ed.2d 425 (1980). Complex tests produce appeals and reversals, encourage gamesmanship, and, again, diminish the likelihood that results and settlements will reflect a claim's legal and factual merits. Judicial resources too are at stake. Courts have an independent obligation to determine whether subject-matter jurisdiction exists, even when no party challenges it. *Arbaugh v. Y & H Corp*., 546 U.S. 500, 514, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006) (citing *Ruhrgas AG v. Marathon Oil Co.,* 526 U.S. 574, 583, 119 S.Ct. 1563, 143 L.Ed.2d 760 (1999)). So courts benefit from straightforward rules under which they can readily assure themselves of their power to hear a case. *Arbaugh, supra,* at 514, 126 S.Ct. 1235.

Simple jurisdictional rules also promote greater predictability. Predictability is valuable to corporations making business and investment decisions. Cf. *First Nat. City Bank v. Banco Para El Comercio Exterior de Cuba,* 462 U.S. 611, 621, 103 S.Ct. 2591, 77 L.Ed.2d 46 (1983) (recognizing the "need for certainty and predictability ***95** of result while generally protecting the justified expectations of parties with interests in the corporation"). Predictability also benefits plaintiffs deciding whether to file suit in a state or federal court.

A "nerve center" approach, which ordinarily equates that "center" with a corporation's headquarters, is simple to apply *comparatively speaking*. The metaphor of a corporate "brain," while not precise, suggests a single location. By contrast, a corporation's general business activities ****1194** more often lack a single principal place where they take place. That is to say, the corporation may have several plants, many sales locations, and employees located in many different places. If so, it will not be as easy to determine which of these different business locales is the "principal" or most important "place."

Third, the statute's legislative history, for those who accept it, offers a simplicity-related interpretive benchmark. The Judicial Conference provided an initial version of its proposal that suggested a numerical test. A corporation would be deemed a citizen of the State that accounted for more than half of its gross income. Mar. Committee Rept. 14–15; see *supra,* at 1189. The Conference changed its mind in light of criticism that such a test would prove too complex and impractical to apply. Sept. Committee Rept. 2; see also H. Rep. 1706, at 28; S. Rep. 1830, at 31. That history suggests that the words "principal place of business" should be interpreted to be no more complex than the initial "half of gross income" test. A "nerve center" test offers such a possibility. A general business activities test does not.

B

We recognize that there may be no perfect test that satisfies all administrative and purposive criteria. We recognize as well that, under the "nerve center" test we adopt today, there will be hard cases. For example, in this era of telecommuting, some corporations may divide their command ***96** and coordinating functions among officers who work at several different locations, perhaps communicating over the Internet. That said, our test nonetheless points courts in a single direction, towards the center of overall direction, control, and coordination. Courts do not have to try to weigh corporate functions, assets, or revenues different in kind, one from the other. Our approach provides a sensible test that is relatively easier to apply, not a test that will, in all instances, automatically generate a result.

We also recognize that the use of a "nerve center" test may in some cases produce results that seem to cut against the basic rationale for 28 U.S.C. § 1332, see *supra,* at 1188. For example, if the bulk of a company's business activities visible to the public take place in New Jersey, while its top officers direct those activities just across the river in New York, the "principal place of business" is New York. One could argue that members of the public in New Jersey would be *less* likely to be prejudiced against the corporation than persons in New York—yet the corporation will still be entitled to remove a New Jersey state case to federal court. And note too that the same corporation would be unable to remove a New York state case to federal court, despite the New York public's presumed prejudice against the corporation.

We understand that such seeming anomalies will arise. However, in view of the necessity of having a clearer rule, we must accept them. Accepting occasionally counterintuitive results is the price the legal system must pay to avoid overly complex jurisdictional administration while producing the benefits that accompany a more uniform legal system.

[7] **[8]** **[9]** The burden of persuasion for establishing diversity jurisdiction, of course, remains on the party asserting it. *Kokkonen v. Guardian Life Ins. Co. of America,* 511 U.S. 375, 377, 114 S.Ct. 1673, 128 L.Ed.2d 391 (1994); *McNutt v. General Motors Acceptance Corp.,* 298 U.S. 178, 189, 56 S.Ct. 780, 80 L.Ed. 1135 (1936); see also 13E Wright & Miller § 3602.1, at 119. When challenged on allegations of jurisdictional facts, the parties must support ****1195** their allegations by competent ***97** proof. *McNutt, supra,* at 189, 56 S.Ct. 780; 15 Moore's § 102.14, at 102–32 to 102–32.1. And when faced with such a challenge, we reject suggestions such as, for example, the one made by petitioner that the mere filing of a form like the Securities and Exchange Commission's Form 10–K listing a corporation's " principal executive offices" would, without more, be sufficient proof to establish a corporation's "nerve center." See, *e.g.,* SEC Form 10–K, online at http://www.sec.gov/about/forms/ form10–k.pdf. (as visited Feb. 19, 2010, and available in Clerk of Court's case file). Cf. *Dimmitt & Owens Financial, Inc. v. United States,* 787 F.2d 1186, 1190–1192 (C.A.7 1986) (distinguishing "principal executive office" in the tax lien context, see 26 U.S.C. § 6323(f)(2), from "principal place of business" under 28 U.S.C. § 1332(c)). Such possibilities would readily permit jurisdictional manipulation, thereby subverting a major reason for the insertion of the "principal place of business" language in the diversity statute. Indeed, if the record reveals attempts at manipulation—for example, that the alleged "nerve center" is nothing more than a mail drop box, a bare office with a computer, or the location of an annual executive retreat—the courts should instead take as the "nerve center" the place of actual direction, control, and coordination, in the absence of such manipulation.

VI

[10] Petitioner's unchallenged declaration suggests that Hertz's center of direction, control, and coordination, its "nerve center," and its corporate headquarters are one and the same, and they are located in New Jersey, not in California. Because respondents should have a fair opportunity to litigate their case in light of our holding, however, we vacate the Ninth Circuit's judgment and remand the case for further proceedings consistent with this opinion.

It is so ordered.

All Citations

559 U.S. 77, 130 S.Ct. 1181, 175 L.Ed.2d 1029, 78 USLW 4153, 10 Cal. Daily Op. Serv. 2181, 2010 Daily Journal D.A.R. 2667, 22 Fla. L. Weekly Fed. S 130

Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

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TAB 75

66 S.Ct. 154
Supreme Court of the United States

INTERNATIONAL SHOE CO.
v.
STATE OF WASHINGTON, OFFICE OF UNEMPLOYMENT COMPENSATION AND PLACEMENT et al.

No. 107.
|
Decided Dec. 3, 1945.

Proceeding by the State of Washington, Office of Unemployment Compensation and Placement, and E. B. Riley, Commissioner, against the International Shoe Company to recover contributions under the Unemployment Compensation Act. From a judgment of the Supreme Court of Washington, 154 P.2d 801, affirming a judgment in favor of the plaintiff, the defendant appeals under s 237(a) of the Judicial Code, 28 U.S.C.A. s 344(a).

Affirmed.

****156** ***311** Appeal from the Supreme Court of the State of Washington.

Attorneys and Law Firms

Mr. Henry C. Lowenhaupt, of St. Louis Mo., for appellant.

Mr. George W. Wilkins, of Olympia, Wash., for appellees.

Opinion

Mr. Chief Justice STONE delivered the opinion of the Court.

The questions for decision are (1) whether, within the limitations of the due process clause of the Fourteenth Amendment, appellant, a Delaware corporation, has by its activities in the State of Washington rendered itself amenable to proceedings in the courts of that state to recover unpaid contributions to the state unemployment compensation fund exacted by state statutes, Washington Unemployment Compensation Act, Washington Revised Statutes, s 9998—103a through s 9998—123a, 1941 Supp., and (2) whether the state can exact those contributions consistently with the due process clause of the Fourteenth Amendment.

The statutes in question set up a comprehensive scheme of unemployment compensation, the costs of which are defrayed by contributions required to be made by employers to a state unemployment compensation fund. ***312** The contributions are a specified percentage of the wages payable annually by each employer for his employees' services in the state. The assessment and collection of the contributions and the fund are administered by respondents. Section 14(c) of the Act, Wash.Rev.Stat. 1941 Supp., s 9998—114c, authorizes respondent Commissioner to issue an order and notice of assessment of delinquent contributions upon prescribed personal service of the notice upon the employer if found within the state, or, if not so found, by mailing the notice to the employer by registered mail at his last known address. That section also authorizes the Commissioner to collect the assessment by distraint if it is not paid within ten days after service of the notice. By ss 14(e) and 6(b) the order of assessment may be administratively reviewed by an appeal tribunal within the office of unemployment upon petition of the employer, and this determination is by s 6(i) made subject to judicial review on questions of law by the state Superior Court, with further right of appeal in the state Supreme Court as in other civil cases.

In this case notice of assessment for the years in question was personally served upon a sales solicitor employed by appellant in the State of Washington, and a copy of the notice was mailed by registered mail to appellant at its address in St. Louis, Missouri. Appellant appeared specially before the office of unemployment and moved to set aside the order and notice of assessment on the ground that the service upon appellant's salesman was not proper service upon appellant; that appellant was not a corporation of the State of Washington and was not doing business within the state; that it had no agent within the state upon whom service could be made; and that appellant is not an employer and does not furnish employment within the meaning of the statute.

The motion was heard on evidence and a stipulation of facts by the appeal tribunal which denied the motion ***313** and ruled that respondent Commissioner was entitled to recover the unpaid contributions. That action ****157** was affirmed by the Commissioner; both the Superior Court and the Supreme Court affirmed. 154 P.2d 801. Appellant in each of these courts assailed the statute as applied, as a violation of the due process clause of the Fourteenth Amendment, and as imposing a constitutionally prohibited burden on interstate commerce. The cause comes here on appeal under s 237(a) of the Judicial Code, 28 U.S.C. s 344(a), 28 U.S.C.A. s 344(a), appellant assigning as error that the challenged statutes as applied infringe the due process clause of the Fourteenth Amendment and the commerce clause.

The facts as found by the appeal tribunal and accepted by the state Superior Court and Supreme Court, are not in dispute. Appellant is a Delaware corporation, having its principal place of business in St. Louis, Missouri, and is engaged in the manufacture and sale of shoes and other footwear. It maintains places of business in several states, other than Washington, at which its manufacturing is carried on and from which its merchandise is distributed interstate through several sales units or branches located outside the State of Washington.

Appellant has no office in Washington and makes no contracts either for sale or purchase of merchandise there. It maintains no stock of merchandise in that state and makes there no deliveries of goods in intrastate commerce. During the years from 1937 to 1940, now in question, appellant employed eleven to thirteen salesmen under direct supervision and control of sales managers located in St. Louis. These salesmen resided in Washington; their principal activities were confined to that state; and they were compensated by commissions based upon the amount of their sales. The commissions for each year totaled more than $31,000. Appellant supplies its salesmen with a line of samples, each consisting of one shoe of a pair, which ***314** they display to prospective purchasers. On occasion they rent permanent sample rooms, for exhibiting samples, in business buildings, or rent rooms in hotels or business buildings temporarily for that purpose. The cost of such rentals is reimbursed by appellant.

The authority of the salesmen is limited to exhibiting their samples and soliciting orders from prospective buyers, at prices and on terms fixed by appellant. The salesmen transmit the orders to appellant's office in St. Louis for acceptance or rejection, and when accepted the merchandise for filling the orders is shipped f.o.b. from points outside Washington to the purchasers within the state. All the merchandise shipped into Washington is invoiced at the place of shipment from which collections are made. No salesman has authority to enter into contracts or to make collections.

The Supreme Court of Washington was of opinion that the regular and systematic solicitation of orders in the state by appellant's salesmen, resulting in a continuous flow of appellant's product into the state, was sufficient to constitute doing business in the state so as to make appellant amenable to suit in its courts. But it was also of opinion that there were sufficient additional activities shown to bring the case within the rule frequently stated, that solicitation within a state by the agents of a foreign corporation plus some additional activities there are sufficient to render the corporation amenable to suit brought in the courts of the state to enforce an obligation arising out of its activities there. International Harvester Co. v. Kentucky, 234 U.S. 579, 587, 34 S.Ct. 944, 946, 58 L.Ed. 1479; People's Tobacco Co. v. American Tobacco Co., 246 U.S. 79, 87, 38 S.Ct. 233, 235, 62 L.Ed. 587, Ann.Cas.1918C, 537; Frene v. Louisville Cement Co., 77 U.S.App.D.C. 129, 134 F.2d 511, 516, 146 A.L.R. 926. The court found such additional activities in the salesmen's display of samples sometimes in permanent display rooms, and the salesmen's residence within the state, continued over a period of years, all resulting in a ***315** substantial volume of merchandise regularly shipped by appellant to purchasers within the state.

The court also held that the statute as applied did not invade the constitutional power of Congress to regulate interstate commerce and did not impose a prohibited burden on such commerce.

[1] **[2]** Appellant's argument, renewed here, that the statute imposes an unconstitutional burden on interstate commerce need not detain us. For 53 Stat. 1391, 26 U.S.C. s 1606(a), 26 U.S.C.A. Int.Rev.Code, s 1606(a), provides that 'No person required under a State law to make payments to an unemployment fund shall be ****158** relieved from compliance therewith on the ground that he is engaged in interstate or foreign commerce, or that the State law does not distinguish between employees engaged in interstate or foreign commerce and those engaged in intrastate commerce.' It is no longer debatable that Congress, in the exercise of the commerce power, may authorize the states, in specified ways, to regulate interstate commerce or impose burdens upon it. Kentucky Whip & Collar Co. v. Illinois Central R. Co., 299 U.S. 334, 57 S.Ct. 277, 81 L.Ed. 270; Perkins v. Pennsylvania, 314 U.S. 586, 62 S.Ct. 484, 86 L.Ed. 473; Standard Dredging Corp. v. Murphy, 319 U.S. 306, 308, 63 S.Ct. 1067, 1068, 87 L.Ed. 1416; Hooven & Allison v. Evatt, 324 U.S. 652, 679, 65 S.Ct. 870, 883; Southern Pacific Co. v. Arizona, 325 U.S. 761, 769, 65 S.Ct. 1515, 1520.

Appellant also insists that its activities within the state were not sufficient to manifest its 'presence' there and that in its absence the state courts were without jurisdiction, that consequently it was a denial of due process for the state to subject appellant to suit. It refers to those cases in which it was said that the mere solicitation of orders for the purchase of goods within a state, to be accepted without the state and filled by shipment of the purchased goods interstate, does not render the corporation seller amenable to suit within the state. See Green v. Chicago, Burlington & Quincy R. Co., 205 U.S. 530, 533, 27 S.Ct. 595, 596, 51 L.Ed. 916; International Harvester Co. v. Kentucky, supra, 234 U.S. 586, 587, 34 S.Ct. 946, 58 L.Ed. 1479; Philadelphia & Reading R. Co. v. McKibbin, 243 U.S. 264, 268, 37 S.Ct. 280, 61 L.Ed. 710; People's Tobacco Co. v. American Tobacco Co., supra, 246 U.S. 87, 38 S.Ct. 235, 62 L.Ed. 587, Ann.Cas.1918C, 537. ***316** And appellant further argues that since it was not present within the state, it is a denial of due process to subject it to taxation or other money exaction. It thus denies the power of the state to lay the tax or to subject appellant to a suit for its collection.

[3] Historically the jurisdiction of courts to render judgment in personam is grounded on their de facto power over the defendant's person. Hence his presence within the territorial jurisdiction of court was prerequisite to its rendition of a judgment personally binding him. Pennoyer v. Neff, 95 U.S. 714, 733, 24 L.Ed. 565. But now that the capias ad respondendum has given way to personal service of summons or other form of notice, due process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.' Milliken v. Meyer, 311 U.S. 457, 463, 61 S.Ct. 339, 343, 85 L.Ed. 278, 132 A.L.R. 1357. See Holmes, J., in McDonald v. Mabee, 243 U.S. 90, 91, 37 S.Ct. 343, 61 L.Ed. 608, L.R.A.1917F, 458. Compare Hoopeston Canning Co. v. Cullen, 318 U.S. 313, 316, 319, 63 S.Ct. 602, 604, 606, 87 L.Ed. 777, 145 A.L.R. 1113. See Blackmer v. United States, 284 U.S. 421, 52 S.Ct. 252, 76 L.Ed. 375; Hess v. Pawloski, 274 U.S. 352, 47 S.Ct. 632, 71 L.Ed. 1091; Young v. Masci, 289 U.S. 253, 53 S.Ct. 599, 77 L.Ed. 1158, 88 A.L.R. 170.

[4] **[5]** Since the corporate personality is a fiction, although a fiction intended to be acted upon as though it were a fact, Klein v. Board of Tax Supervisors, 282 U.S. 19, 24, 51 S.Ct. 15, 16, 75 L.Ed. 140, 73 A.L.R. 679, it is clear that unlike an individual its 'presence' without, as well as within, the state of its origin can be manifested only by activities carried on in its behalf by those who are authorized to act for it. To say that the corporation is so far 'present' there as to satisfy due process requirements, for purposes of taxation or the maintenance of suits against it in the courts of the state, is to beg the question to be decided. For the terms 'present' or 'presence' are ***317** used merely to symbolize those activities of the corporation's agent within the state which courts will deem to be sufficient to satisfy the demands of due process. L. Hand, J., in Hutchinson v. Chase & Gilbert, 2 Cir., 45 F.2d 139, 141. Those demands may be met by such contacts of the corporation with the state of the forum as make it reasonable, in the context of our federal system of government, to require the corporation to defend the particular suit which is brought there. An 'estimate of the inconveniences' which would result to the corporation from a trial away from its 'home' or principal place of business is relevant in this connection. Hutchinson v. Chase & Gilbert, supra, 45 F.2d 141.

****159 [6] [7]** 'Presence' in the state in this sense has never been doubted when the activities of the corporation there have not only been continuous and systematic, but also give rise to the liabilities sued on, even though no consent to be sued or authorization to an agent to accept service of process has been given. St. Clair v. Cox, 106 U.S. 350, 355, 1 S.Ct. 354, 359, 27 L.Ed. 222; Connecticut Mutual Life Ins. Co. v. Spratley, 172 U.S. 602, 610, 611, 19 S.Ct. 308, 311, 312, 43 L.Ed. 569; Pennsylvania Lumbermen's Mut. Fire Ins. Co. v. Meyer, 197 U.S. 407, 414, 415, 25 S.Ct. 483, 484, 485, 49 L.Ed. 810; Commercial Mutual Accident Co. v. Davis, 213 U.S. 245, 255, 256, 29 S.Ct. 445, 448, 53 L.Ed. 782; International Harvester Co. v. Kentucky, supra; cf. St. Louis S.W.R. Co. v. Alexander, 227 U.S. 218, 33 S.Ct. 245, 57 L.Ed. 486, Ann.Cas.1915B, 77. Conversely it has been generally recognized that the casual presence of the corporate agent or even his conduct of single or isolated items of activities in a state in the corporation's behalf are not enough to subject it to suit on causes of action unconnected with the activities there. St. Clair v. Cox, supra, 106 U.S. 359, 360, 1 S.Ct. 362, 363, 27 L.Ed. 222; Old Wayne Mut. Life Ass'n v. McDonough, 204 U.S. 8, 21, 27 S.Ct. 236, 240, 51 L.Ed. 345; Frene v. Louisville Cement Co., supra, 77 U.S.App.D.C. 133, 134 F.2d 515, 146 A.L.R. 926, and cases cited. To require the corporation in such circumstances to defend the suit away from its home or other jurisdiction where it carries on more substantial activities has been thought to lay too great and unreasonable a burden on the corporation to comport with due process.

***318** While it has been held in cases on which appellant relies that continuous activity of some sorts within a state is not enough to support the demand that the corporation be amenable to suits unrelated to that activity, Old Wayne Mut. Life Ass'n v. McDonough, supra; Green v. Chicago, Burlington & Quincy R. Co., supra; Simon v. Southern R. Co., 236 U.S. 115, 35 S.Ct. 255, 59 L.Ed. 492; People's Tobacco Co. v. American Tobacco Co., supra; cf. Davis v. Farmers' Co-operative Equity Co., 262 U.S. 312, 317, 43 S.Ct. 556, 558, 67 L.Ed. 996, there have been instances in which the continuous corporate operations within a state were thought so substantial and of such a nature as to justify suit against it on causes of action arising from dealings entirely distinct from those activities. See Missouri, K. & T.R. Co. v. Reynolds, 255 U.S. 565, 41 S.Ct. 446, 65 L.Ed. 788; Tauza v. Susquehanna Coal Co., 220 N.Y. 259, 115 N.E. 915; cf. St. Louis S.W.R. Co. v. Alexander, supra.

[8] Finally, although the commission of some single or occasional acts of the corporate agent in a state sufficient to impose an obligation or liability on the corporation has not been thought to confer upon the state authority to enforce it, Rosenberg Bros. & Co. v. Curtis Brown Co., 260 U.S. 516, 43 S.Ct. 170, 67 L.Ed. 372, other such acts, because of their nature and quality and the circumstances of their commission, may be deemed sufficient to render the corporation liable to suit. Cf. Kane v. New Jersey, 242 U.S. 160, 37 S.Ct. 30, 61 L.Ed. 222; Hess v. Pawloski, supra; Young v. Masci, supra. True, some of the decisions holding the corporation amenable to suit have been supported by resort to the legal fiction that it has given its consent to service and suit, consent being implied from its presence in the state through the acts of its authorized agents. Lafayette Insurance Co. v. French, 18 How. 404, 407, 15 L.Ed. 451; St. Clair v. Cox, supra, 106 U.S. 356, 1 S.Ct. 359, 27 L.Ed. 222; Commercial Mutual Accident Co. v. Davis, supra, 213 U.S. 254, 29 S.Ct. 447, 53 L.Ed. 782; State of Washington v. Superior Court, 289 U.S. 361, 364, 365, 53 S.Ct. 624, 626, 627, 77 L.Ed. 1256, 89 A.L.R. 653. But more realistically it may be said that those authorized acts were of such a nature as to justify the fiction. Smolik v. Philadelphia & R.C. & I. Co., D.C., 222 F. 148, 151. ***319** Henderson, The Position of Foreign Corporations in American Constitutional Law, 94, 95.

[9] [10] It is evident that the criteria by which we mark the boundary line between those activities which justify the subjection of a corporation to suit, and those which do not, cannot be simply mechanical or quantitative. The test is not merely, as has sometimes been suggested, whether the activity, which the corporation has seen fit to procure through its agents in another state, is a little more or a little less. St. Louis S.W.R. Co. v. Alexander, supra, 227 U.S. 228, ****160** 33 S.Ct. 248, 57 L.Ed. 486, Ann.Cas.1915B, 77; International Harvester Co. v. Kentucky, supra, 234 U.S. 587, 34 S.Ct. 946, 58 L.Ed. 1479. Whether due process is satisfied must depend rather upon the quality and nature of the activity in relation to the fair and orderly administration of the laws which it was the purpose of the due process clause to insure. That clause does not contemplate that a state may make binding a judgment in personam against an individual or corporate defendant with which the state has no contacts, ties, or relations. Cf. Pennoyer v. Neff, supra; Minnesota Commercial Men's Ass'n v. Benn, 261 U.S. 140, 43 S.Ct. 293, 67 L.Ed. 573.

[11] But to the extent that a corporation exercises the privilege of conducting activities within a state, it enjoys the benefits and protection of the laws of that state. The exercise of that privilege may give rise to obligations; and, so far as those obligations arise out of or are connected with the activities within the state, a procedure which requires the corporation to respond to a suit brought to enforce them can, in most instances, hardly be said to be undue. Compare International Harvester Co. v. Kentucky, supra, with Green v. Chicago, Burlington & Quincy R. Co., supra, and People's Tobacco Co. v. American Tobacco Co., supra. Compare Connecticut Mutual Life Ins. Co. v. Spratley, supra, 172 U.S. 619, 620, 19 S.Ct. 314, 315, 43 L.Ed. 569, and Commercial Mutual Accident Co. v. Davis, supra, with Old Wayne Mut. Life Ass'n v. McDonough, supra. See 29 Columbia Law Review, 187-195.

[12] ***320** Applying these standards, the activities carried on in behalf of appellant in the State of Washington were neither irregular nor casual. They were systematic and continuous throughout the years in question. They resulted in a large volume of interstate business, in the course of which appellant received the benefits and protection of the laws of the state, including the right to resort to the courts for the enforcement of its rights. The obligation which is here sued upon arose out of those very activities. It is evident that these operations establish sufficient contacts or ties with the state of the forum to make it reasonable and just according to our traditional conception of fair play and substantial justice to permit the state to enforce the obligations which appellant has incurred there. Hence we cannot say that the maintenance of the present suit in the State of Washington involves an unreasonable or undue procedure.

[13] **[14]** **[15]** We are likewise unable to conclude that the service of the process within the state upon an agent whose activities establish appellant's ‘presence’ there was not sufficient notice of the suit, or that the suit was so unrelated to those activities as to make the agent an inappropriate vehicle for communicating the notice. It is enough that appellant has established such contacts with the state that the particular form of substituted service adopted there gives reasonable assurance that the notice will be actual. Connecticut Mutual Life Ins. Co. v. Spratley, supra, 172 U.S. 618, 619, 19 S.Ct. 314, 315, 43 L.Ed. 569; Board of Trade v. Hammond Elevator Co., 198 U.S. 424, 437, 438, 25 S.Ct. 740, 743, 744, 49 L.Ed. 1111; Commercial Mutual Accident Co. v. Davis, supra, 213 U.S. 254, 255, 29 S.Ct. 447, 448, 53 L.Ed. 782. Cf. Riverside & Dan River Cotton Mills v. Menefee, 237 U.S. 189, 194, 195, 35 S.Ct. 579, 580, 581, 59 L.Ed. 910; see Knowles v. Gaslight & Coke Co., 19 Wall. 58, 61, 22 L.Ed. 70; McDonald v. Mabee, supra; Milliken v. Meyer, supra. Nor can we say that the mailing of the notice of suit to appellant by registered mail at its home office was not reasonably calculated to apprise appellant of the suit. Compare Hess v. Pawloski, supra, with McDonald v. Mabee, supra, 243 U.S. 92, 37 S.Ct. 344, 61 L.Ed. 608, L.R.A.1917F, 458, ***321** and Wuchter v. Pizzutti, 276 U.S. 13, 19, 24, 48 S.Ct. 259, 260, 262, 72 L.Ed. 446, 57 A.L.R. 1230; cf. Bequet v. MacCarthy, 2 B. & Ad. 951; Maubourquet v. Wyse, 1 Ir.Rep.C.L. 471. See State of Washington v. Superior Court, supra, 289 U.S. 365, 53 S.Ct. 626, 77 L.Ed. 1256, 89 A.L.R. 653.

[16] Only a word need be said of appellant's liability for the demanded contributions of the state unemployment fund. The Supreme Court of Washington, construing and applying the statute, has held that it imposes a tax on the privilege of employing appellant's salesmen within the state measured by a percentage of the wages, here the commissions payable to the salesmen. This construction we accept for purposes of determining the constitutional validity of the statute. The right to employ labor has been ****161** deemed an appropriate subject of taxation in this country and England, both before and since the adoption of the Constitution. Steward Machine Co. v. Davis, 301 U.S. 548, 579 et seq., 57 S.Ct. 883, 887 et seq., 81 L.Ed. 1279, 109 A.L.R. 1293. And such a tax imposed upon the employer for unemployment benefits is within the constitutional power of the states. Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 508 et seq., 57 S.Ct. 868, 871 et seq., 81 L.Ed. 1245, 109 A.L.R. 1327.

Appellant having rendered itself amenable to suit upon obligations arising out of the activities of its salesmen in Washington, the state may maintain the present suit in personam to collect the tax laid upon the exercise of the privilege of employing appellant's salesmen within the state. For Washington has made one of those activities, which taken together establish appellant's ‘presence’ there for purposes of suit, the taxable event by which the state brings appellant within the reach of its taxing power. The state thus has constitutional power to lay the tax and to subject appellant to a suit to recover it. The activities which establish its 'presence' subject it alike to taxation by the state and to suit to recover the tax. Equitable Life Assur. Society v. Pennsylvania, 238 U.S. 143, 146, 35 S.Ct. 829, 830, 59 L.Ed. 1239; cf. International Harvester Co. v. Wisconsin Department of Taxation, 322 U.S. 435, 442 et seq., 64 S.Ct. 1060, 1064 et seq., 88 L.Ed. 1373; Hoopeston Canning Co. v. Cullen, supra, 318 U.S. 316—319, 63 S.Ct. 604—606, 87 L.Ed. 1722, 145 A.L.R. 113; ***322** see General Trading Co. v. State Tax Com., 322 U.S. 335, 349, 64 S.Ct. 1028, 1030, 88 L.Ed. 1309, 1319.

Affirmed.

Mr. Justice JACKSON took no part in the consideration or decision of this case.

Mr. Justice BLACK delivered the following opinion.

Congress, pursuant to its constitutional power to regulate commerce, has expressly provided that a State shall not be prohibited from levying the kind of unemployment compensation tax here challenged. 26 U.S.C. s 1606, 26 U.S.C.A. Int.Rev.Code, s 1606. We have twice decided that this Congressional consent is an adequate answer to a claim that imposition of the tax violates the Commerce Clause. Perkins v. Pennsylvania, 314 U.S. 586, 62 S.Ct. 484, 86 L.Ed. 473, affirming 342 Pa. 529, 21 A.2d 45; Standard Dredging Corp. v. Murphy, 319 U.S. 306, 308, 63 S.Ct. 1067, 1068, 87 L.Ed. 1416. Two determinations by this Court of an issue so palpably without merit are sufficient. Consequently that part of this appeal which again seeks to raise the question seems so patently frivolous as to make the case a fit candidate for dismissal. Fay v. Crozer, 217 U.S. 455, 30 S.Ct. 568, 54 L.Ed. 837. Nor is the further ground advanced on this appeal, that the State of Washington has denied appellant due process of law, any less devoid of substance. It is my view, therefore, that we should dismiss the appeal as unsubstantial,[1] Seaboard Air Line R. Co. v. Watson, 287 U.S. 86, 90, 92, 53 S.Ct. 32, 34, 35, 77 L.Ed. 180, 86 A.L.R. 174; and decline the invitation to formulate broad rules as to the meaning of due process, which here would amount to deciding a constitutional question 'in advance of the necessity for its decision.' Alabama State Federation of Labor v. McAdory, 325 U.S. 450, 461, 65 S.Ct. 1384, 1389, 89 L.Ed. 1725, 1734.

***323** Certainly appellant can not in the light of our past decisions meritoriously claim that notice by registered mail and by personal service on its sales solicitors in Washington did not meet the requirements of procedural due process. And the due process clause is not brought in issue any more by appellant's further conceptualistic contention that Washington could not levy a tax or bring suit against the corporation because it did not honor that State with its mystical 'presence.' For it is unthinkable that the vague due process clause was ever intended to prohibit a State from regulating or taxing a business carried on within its boundaries simply because this is done by agents of a corporation organized and having its headquarters elsewhere. ****162** To read this into the due process clause would in fact result in depriving a State's citizens of due process by taking from the State the power to protect them in their business dealings within its boundaries with representatives of a foreign corporation. Nothing could be more irrational or more designed to defeat the function of our federative system of government. Certainly a State, at the very least, has power to tax and sue those dealing with its citizens within its boundaries, as we have held before. Hoopeston Canning Co. v. Cullen, 318 U.S. 313, 63 S.Ct. 602, 87 L.Ed. 1722, 145 A.L.R. 1113. Were the Court to follow this principle, it would provide a workable standard for cases where, as here, no other questions are involved. The Court has not chosen to do so, but instead has engaged in an unnecessary discussion in the course of which it has announced vague Constitutional criteria applied for the first time to the issue before us. It has thus introduced uncertain elements confusing the simple pattern and tending to curtail the exercise of State powers to an extent not justified by the Constitution.

The criteria adopted insofar as they can be identified read as follows: Due process does permit State courts to 'enforce the obligations which appellant has incurred' if ***324** it be found 'reasonable and just according to our traditional conception of fair play and substantial justice.' And this in turn means that we will 'permit' the State to act if upon 'an 'estimate of the inconveniences' which would result to the corporation from a trial away from its 'home' or principal place of business', we conclude that it is 'reasonable' to subject it to suit in a State where it is doing business.

It is true that this Court did use the terms 'fair play' and 'substantial justice' in explaining the philosophy underlying the holding that it could not be 'due process of law' to render a personal judgment against a defendant without notice to and an opportunity to be heard by him. Milliken v. Meyer, 311 U.S. 457, 61 S.Ct. 339, 85 L.Ed. 278, 132 A.L.R. 1357. In McDonald v. Mabee, 243 U.S. 90, 91, 37 S.Ct. 343, 61 L.Ed. 608, L.R.A.1917F, 458, cited in the Milliken case, Mr. Justice Holmes speaking for the Court warned against judicial curtailment of this opportunity to be heard and referred to such a curtailment as a denial of 'fair play', which even the common law would have deemed 'contrary to natural justice.' And previous cases had indicated that the ancient rule against judgments without notice had stemmed from 'natural justice' concepts. These cases, while giving additional reasons why notice under particular circumstances is inadequate, did not mean thereby that all legislative enactments which this Court might deem to be contrary to natural justice ought to be held invalid under the due process clause. None of the cases purport to support or could support a holding that a State can tax and sue corporations only if its action comports with this Court's notions of 'natural justice.' I should have thought the Tenth Amendment settled that.

I believe that the Federal Constitution leaves to each State, without any 'ifs' or 'buts', a power to tax and to open the doors of its courts for its citizens to sue corporations whose agents do business in those States. Believing that the Constitution gave the States that power, I think it a judicial deprivation to condition its exercise upon this ***325** Court's notion of 'fairplay', however appealing that term may be. Nor can I stretch the meaning of due process so far as to authorize this Court to deprive a State of the right to afford judicial protection to its citizens on the ground that it would be more 'convenient' for the corporation to be sued somewhere else.

There is a strong emotional appeal in the words 'fair play', 'justice', and 'reasonableness.' But they were not chosen by those who wrote the original Constitution or the Fourteenth Amendment as a measuring rod for this Court to use in invalidating State or Federal laws passed by elected legislative representatives. No one, not even those who most feared a democratic government, ever formally proposed that courts should be given power to invalidate legislation under any such elastic standards. Express prohibitions against certain types of legislation are found in the Constitution, and under the long settled practice, courts invalidate laws found to conflict with them. This requires interpretation, and interpretation, it is true, may result in extension of the Constitution's purpose. But that is no reason for reading the due process clause so as to restrict a State's power to tax and sue ****163** those whose activities affect persons and businesses within the State, provided proper service can be had. Superimposing the natural justice concept on the Constitution's specific prohibitions could operate as a drastic abridgment of democratic safeguards they embody, such as freedom of speech, press and religion,[2] and the right to counsel. This ***326** has already happened. Betts v. Brady, 316 U.S. 455, 62 S.Ct. 1252, 86 L.Ed. 1595. Compare Feldman v. United States, 322 U.S. 487, 494—503, 64 S.Ct. 1082, 1085—1089, 88 L.Ed. 1408, 154 A.L.R. 982. For application of this natural law concept, whether under the terms 'reasonableness', 'justice', or 'fair play', makes judges the supreme arbiters of the country's laws and practices. Polk Co. v. Glover, 305 U.S. 5, 17—18, 59 S.Ct. 15, 20, 21, 83 L.Ed. 6; Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575, 600, 62 S.Ct. 736, 750, 86 L.Ed. 1037, note 4. This result, I believe, alters the form of government our Constitution provides. I cannot agree.

True, the State's power is here upheld. But the rule announced means that tomorrow's judgment may strike down a State or Federal enactment on the ground that it does not conform to this Court's idea of natural justice. I therefore find myself moved by the same fears that caused Mr. Justice Holmes to say in 1930:

'I have not yet adequately expressed the more than anxiety that I feel at the ever increasing scope given to the Fourteenth Amendment in cutting down what I believe to be the constitutional rights of the States. As the decisions now stand, I see hardly any limit but the sky to the invalidating of those rights if they happen to strike a majority of this Court as for any reason undesirable.' Baldwin v. Missouri, 281 U.S. 586, 595, 50 S.Ct. 436, 439, 74 L.Ed. 1056, 72 A.L.R. 1303.

All Citations

326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95, 161 A.L.R. 1057

Footnotes

[1] This Court has on several occasions pointed out the undesirable consequences of a failure to dismiss frivolous appeals. Salinger v. United States, 272 U.S. 542, 544, 47 S.Ct. 173, 174, 71 L.Ed. 398; United Surety Co. v. American Fruit Product Co., 238 U.S. 140, 35 S.Ct. 828, 59 L.Ed. 1238; De Bearn v. Safe Deposit & Trust Co., 233 U.S. 24, 33, 34, 34 S.Ct. 584, 586, 587, 58 L.Ed. 833.

[2] These First Amendment liberties—freedom of speech, press and religion—provide a graphic illustration of the potential restrictive capacity of a rule under which they are protected at a particular time only because the Court, as then constituted believes them to be a requirement of fundamental justice. Consequently, under the same rule, another Court, with a different belief as to fundamental justice, could at least as against State action, completely or partially withdraw Constitutional protection from these basic freedoms, just as though the First Amendment had never been written.

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TAB 76

880 F.2d 1531
United States Court of Appeals,
Second Circuit.

KOREA SHIPPING CORPORATION, Plaintiff-Appellant,
v.
NEW YORK SHIPPING ASSOCIATION-INTERNATIONAL LONGSHOREMEN'S ASSOCIATION PENSION TRUST FUND and the Board of Trustees of the NYSA-ILA Pension Trust Fund, Defendants-Appellees.
DELTA STEAMSHIP LINES, INC., Plaintiff-Appellant,
v.
NEW YORK SHIPPING ASSOCIATION-INTERNATIONAL LONGSHOREMEN'S ASSOCIATION PENSION TRUST FUND, the Board of Trustees of the New York Shipping Association International Longshoremen's Association Pension Trust Fund, Defendants-Counterclaim Plaintiffs-Appellees,
Delta Steamship Lines, Inc., Crowley Maritime International (Inc) and
Crowley Maritime Corporation, Counterclaim Co-Defendants Appellants.

Nos. 339, 497, Dockets 88-7636, 88-7774.
|
Argued Dec. 5, 1988.
|
Decided July 24, 1989.

Carriers appealed from judgments of the United States District Court for the Southern District of New York, Edward Weinfeld, Kenneth Conboy and Peter K. Leisure, JJ., ruling that they were "employers" under Multiemployer Pension Plan Amendments Act and were subject to withdrawal liability under the Act after ceasing their operations in the Port of New York, 663 F.Supp. 766 and 688 F.Supp. 1560. The Court of Appeals, Cardamone, Circuit Judge, held that: (1) "employer" under Multiemployer Pension Plan Amendments Act means person who is obligated to contribute to the plan either as a direct employer or in the interest of an employer of the plan's participant, and (2) carriers were "employers" subject to withdrawal liability under Act.

Affirmed and remanded.

Attorneys and Law Firms

***1532** John D. Kimball, New York City (Healy & Baillie, LeRoy Lambert, of counsel), for plaintiff-appellant Korea Shipping Corp.

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Stephen E. Tallent, Washington, D.C. (Paul D. Inman, Gibson, Dunn & Crutcher, Washington, D.C., of counsel), for plaintiff-appellant Delta Steamship Lines, Inc.

Before OAKES, KEARSE and CARDAMONE, Circuit Judges.

Opinion

CARDAMONE, Circuit Judge:

We consider two separate appeals presenting identical legal issues: Whether appellants shipping companies are "employers" under the Multiemployer Pension Plan Amendments Act (MPPAA or the Act), 29 U.S.C. § 1381 *et seq.* (1982), and whether they are therefore subject to "withdrawal liability" under that Act upon ceasing their operations in the Port of New York. The carriers' chief contention is that Congress' use of the term "employer" requires us to construe that word as it is generally understood in the common law, and that under that definition they are not employers for purposes of MPPAA withdrawal liability. On appeal, they argue in effect that the trial courts' wholly different reading of the word employer reinforces the notion that words don't mean what they say but only, as Alice tells us, what we say they mean. *See* L. Carroll, *Alice's Adventures in Wonderland* (London 1865).

Appellant Korea Shipping Corporation (Korea) appeals a grant of summary judgment in favor of defendants, the New York Shipping Association-International Longshoremen's Association Pension Trust Fund (Fund) and its Board of Trustees, that held appellant to be an employer subject to withdrawal liability under the MPPAA. The district court decision, entered on June 25, 1987 by the United States District Court for the Southern District of New York (Weinfeld, J.), reported at 663 F.Supp. 766, was reaffirmed following Judge Weinfeld's death on a motion for reconsideration by Judge Conboy of the Southern District on June 8, 1988. Appellant Delta Steamship Lines (Delta) appeals a similar determination entered on April 5, ***1533** 1988 in the same district court (Leisure, J.), reported at 688 F.Supp. 1560.

These suits were commenced by the carriers as declaratory judgment actions in which they sought rulings that they were not employers under the MPPAA. In both actions, the Fund counterclaimed for the amounts allegedly due as the carriers' withdrawal liabilities. The parties cross-moved for summary judgment on the employer issue in each case, and in both instances the Fund prevailed. The carriers appeal the district court's determinations that as MPPAA employers ceasing operations in the Port of New York they are subject to withdrawal liability. We affirm.

FACTS

A. *Operations at the Port of New York*

The only real dispute between the parties is appellants' status as employers under the MPPAA, and the facts necessary to its resolution are largely agreed upon. To put this issue in proper perspective, it is necessary to examine briefly the unique history of the longshore industry in the Port of New York.

Appellants' vessels called at the Port's marine terminals that are owned and operated by stevedoring companies engaged in the business of loading and unloading ships. A registered pool of longshore employees is available to work the vessels of any carrier; the longshoremen constitute a "floating" work force whose employers change frequently and whose seniority and eligibility for fringe benefits are determined on the basis of their work throughout the Port, not by attachment to any particular company. Carriers provide the work and their ships the workplace. The longshoremen's union negotiates collective bargaining agreements with the stevedoring companies and the carriers that establish the terms and conditions of the longshoremen's employment in the Port.

In litigation concerning whether the Rules on Containers and the work preservation provisions in the longshore contract constituted unlawful secondary activity under §§ 8(b)(4)(B) and 8(e) of the National Labor Relations Act, the carriers were recognized to be longshore employers. *See NLRB v. Int'l Longshoremen's Ass'n,* 447 U.S. 490, 496 n. 10, 100 S.Ct. 2305, 2309 n. 10, 65 L.Ed.2d 289 (1980); *id.* at 499 n. 13, 100 S.Ct. at 2311 n. 13; *id.* at 512, 100 S.Ct. at 2317 (1980); *see* *also NLRB v. Int'l Longshoremen's Ass'n,* 473 U.S. 61, 74 n. 12, 105 S.Ct. 3045, 3053 n. 12, 87 L.Ed.2d 47 (1985). In the Port of New York, the National Labor Relations Board (NLRB) has certified the New York Shipping Association, Inc. (NYSA) as a bargaining unit. Although NYSA's membership consists of carriers, stevedoring companies, carrier agents, and other maritime concerns, the NYSA has historically been under the control of its carrier members.

The obligation for funding the costs of the longshoremen's fringe benefits has been imposed by contract upon the carriers, not on the stevedoring companies. The bitter collective bargaining conflict between the carriers and the International Longshoremen's Association (ILA) sparked by the introduction of containerized methods of cargo handling was finally resolved in 1968 after a lengthy strike and the intervention of a presidential mediator. The labor accord reached required the union to relinquish its demands for limits on containerization in exchange for, among other things, the establishment of a program of enhanced fringe benefits to compensate longshoremen for the effects of the job displacement caused by containerization.

Thus, the advent of containerization and the execution of the 1968 labor contract brought about significant new developments in the carriers' status in the Port of New York. From 1968 to the present the carriers not only continued to negotiate the terms and conditions of longshore employment and the level of longshore employee benefits, but also directly undertook the obligation to pay-and did in fact pay-the contributions necessary to fund these benefits. The key feature of the assessment system in effect in the Port of New York for the past two decades is that the obligation for longshore fringe benefit assessments is placed directly upon the vessel ***1534** carriers based on the tons of cargo loaded and unloaded by longshoremen from their vessels.

Korea and Delta engaged in steamship carrier operations at the Port from 1967 to 1985 and 1978 to 1983 respectively, undertaking a variety of operations which included the loading and unloading of their general cargo and container vessels. Neither company directly employed its own labor force to service its ships, and neither operated its own marine terminal facility. When appellants' ships entered the Port, they called at terminals operated by the stevedoring companies where their vessels loaded and discharged their cargo with the aid of longshoremen directly employed by the stevedoring companies.

B. *Collective Bargaining Agreements*

Operations at the Port are carried out under two collective bargaining agreements-(1) the so-called “master contract,” encompassing operations at major ports on the Atlantic and Gulf coasts of the United States, and (2) a local New York labor accord known as the General Cargo Agreement (GCA). The master contract governs the general terms of employment that apply uniformly in eastern ports where the ILA functions. Both agreements were negotiated by the ILA as the representative of the rank and file longshoremen and by the New York Shipping Association and its counterpart organizations in other eastern ports as the representatives of the carriers, the stevedores, and other employers of longshoremen.

The master contract sets uniform terms applicable to ports in which the ILA functions and covers such items as wages, hours, pension and welfare contributions, containerization agreements, and the payment of “job security program assessments” as a means of offsetting shortfalls in contributions to, *inter alia,* longshoremen pension funds. As members of the NYSA, Korea and Delta were parties to the master contract and, in some instances, were also direct signatories. The General Cargo Agreement, also a product of bargaining between the ILA and the NYSA, governs the local terms and conditions of employment in the Port of New York such as pension benefits, seniority, hiring, safety, and holidays. As is the case with the master contracts, plaintiffs are parties to the GCA not only by reason of their membership in the NYSA, but also as direct signatories.

As previously noted, in signing the master contract and the GCA the carriers obligated themselves to pay "job security program assessments" in order to aid in the funding of shortfalls in certain longshore pension, welfare, and trust funds. In addition to these job security program assessments provided for by the master contract, the GCA imposed other cargo assessments in the Port of New York which from 1974 to 1985 were based solely on tonnage and were paid by the carriers to the NYSA. The NYSA, in turn, paid most of those monies to the NYSA-ILA Fringe Benefits Escrow Fund. It transferred directly to the Fund that portion of the assessment monies to be used for pension plan contributions it had collected from its members. The GCA fixed a guaranteed minimum level of total annual contributions that was designed to ensure the availability of adequate funding for future retirement benefits. In relevant part, the GCA provided

> This agreement shall be executed by the ILA for and on behalf of itself and its affiliated Locals and by New York Shipping Association, Inc. for and on behalf of its employer-members and by each contacting stevedore and vessel carrier who directly or indirectly utilizes the services of any employees covered by this agreement and who by such execution binds itself and its successors to each and every term and condition of the agreement, including, without limitation, the contribution of its proportionate share of the hourly, tonnage and other supplemental and fringe benefit contributions provided herein. If any carrier does not subscribe to this and the accompanying JSP Agreements, the ILA shall have the right not to work on the loading and discharging of its ships or any work ancillary thereto.

***1535** *General Cargo Agreement,* October 1, 1980 to September 30, 1983, at 73-74.

In addition, the GCA provided that each carrier would be subject to an assessment calculated according to a predetermined formula based on the tonnage of cargo loaded or discharged by the carrier in the Port. The agreement set forth the procedures for collection and payment of tonnage assessments:

> Such tonnage assessment shall be collected by the direct employer from each of the carriers and shall be paid to the NYSA for immediate transmittal to the NYSA-ILA Fringe Benefits Escrow Fund ... as collected by said direct employers. Pension payment shall be made by the NYSA directly to the NYSA-ILA Pension Trust Fund. Amounts billed to carriers and not collected by the direct employers shall be reported to the NYSA-ILA Fringe Benefits Escrow fund promptly at the end of each billing period.

Id. at 118-19. Thus, though the NYSA made the contributions to the Fund, it received the funds directly from the carriers that had obligated themselves contractually to make the payments. The agreement places the obligation for funding the longshoremen's fringe benefits squarely upon the carriers' shoulders. Moreover, the Fund is administered pursuant to an Agreement and Declaration of Trust and Plan which defines employer as any entity obligated under agreements such as the GCA to pay tonnage assessments.

Throughout the period when Korea and Delta were actively engaged in business in the Port of New York, they were signatories to and active negotiators of the various labor contracts with the ILA. Until their cessation of operations, appellants regularly complied with their assessment obligations under the GCA. Thus, for the five-year period prior to their withdrawal, they paid assessments of $12.5 million and $10 million, respectively, of which approximately $3.5 million and $3 million constituted pension contributions to the Fund. After the two carriers discontinued operations at the Port of New York, the Fund sought to assess withdrawal liability in accordance with the applicable provisions of the MPPAA. Appellants resisted, arguing that the stevedoring companies were the direct employers of the longshoremen, and that it was those companies that would be responsible for withdrawal liability if and when they ceased serving the New York market.

PRIOR PROCEEDINGS

The three district court judges who ruled on the matter concluded that Korea and Delta were employers subject to withdrawal liability under the MPPAA and therefore granted summary judgment in favor of the Fund. Agreeing with the carriers' contentions that they were not the common law employers of the longshoremen, the district court in each case nonetheless found that the issue of employer status under the MPPAA was not governed by the common law definition. Absent an express definition of employer in the MPPAA itself, and without clear guidance from the legislative history, the district judges believed that the determination of how to construe the term employer was derived from assessing the purposes of the legislation. *See NLRB v. Hearst Publications, Inc.,* 322 U.S. 111, 124, 64 S.Ct. 851, 857, 88 L.Ed. 1170 (1944).

Judges Weinfeld and Leisure accordingly adopted a definition of employer that focused on the obligation to contribute to the pension plan and that imposed withdrawal liability upon the party contractually obligated to make those contributions. They observed that the definition of employer set forth in Title I of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1002(5) (1982 & Supp. V 1987), was not directly applicable to the MPPAA. But the district judges nevertheless drew upon ERISA's definition in holding that the carriers that were contractually obligated to contribute to a plan in the indirect interests of the direct employer (here, the stevedores) could not escape withdrawal liability without threatening "the very effectiveness of the Act." *Korea Shipping,* 663 F.Supp. at 770 (quoted in *Delta S.S.,* 688 F.Supp. at 1566).

***1536** In reaching its determinations, the district court correctly observed that to apply a common law definition of employer to the MPPAA would encourage employers to insulate themselves contractually from liability by entering into agreements under which contributions to the pension plans would be made by entities that were not the direct employers of the plan's beneficiaries. Under such a scenario, the contributing indirect employer could terminate its relationship with the direct employer and thereafter withdraw from the plan without incurring withdrawal liability because, pursuant to the definition of employer urged by appellants, the Act would not be applicable to the contributing indirect employer. At the same time, the direct noncontributing employer would also be absolved of withdrawal liability because it would not be deemed to have "withdraw[n] from a multiemployer plan," 29 U.S.C. § 1381(a), in accordance with the meaning given the term "withdrawal" under the MPPAA. *See* 29 U.S.C. § 1383(a) (defining "withdrawal" as "(1) permanently ceas[ing] to have an obligation to contribute under the plan, or (2) permanently ceas[ing] all covered operations under the plan"). We turn now to analysis of these issues.

DISCUSSION

A. *Definition of Employer*

In enacting ERISA in 1974, 29 U.S.C. § 1001 *et seq.,* Congress sought to prevent the losses suffered by employees and their families when vested pension benefits were not paid because a pension plan was terminated before sufficient funds had been accumulated. *See Pension Benefit Guaranty Corp. v. R.A. Gray & Co.,* 467 U.S. 717, 720, 104 S.Ct. 2709, 2713, 81 L.Ed.2d 601 (1984); *Nachman Corp. v. Pension Benefit Guaranty Corp.,* 446 U.S. 359, 374-75, 100 S.Ct. 1723, 1732-33, 64 L.Ed.2d 354 (1980).

Multiemployer plans developed in industries where job changes are frequent, like longshoring "where workers change employers from day to day or week to week." *NLRB v. Truck Drivers Local Union No. 449,* 353 U.S. 87, 94, 77 S.Ct. 643, 647, 1 L.Ed.2d 676 (1957). Collective bargaining agreements with multiple employers are particularly appropriate in such industries because of the pension protection provided by the pooled funds of many employers. *See Textile*

Workers Pension Fund v. Standard Dye & Finishing Co., 725 F.2d 843, 847 (2d Cir.1984). Subsequent concern for the financial stability of some multiemployer plans prompted Congress, in 1980, to enact that provision of the MPPAA which states: "If an employer withdraws from a multiemployer plan in a complete withdrawal or a partial withdrawal, then the employer is liable to the plan in the amount determined ... to be the withdrawal liability." 29 U.S.C. § 1381(a).

The MPPAA itself contains no definition of the word employer. But Title I of ERISA does contain a definition that would support the Fund's arguments in favor of imposing withdrawal liability upon the carriers, *see* 29 U.S.C. § 1002(5) (defining such status as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan"). Yet, the Supreme Court cautions that though the definitions in Title I "may otherwise reflect the meaning of the terms defined as used in other Titles," *Nachman v. Pension Benefit Guaranty Corp.,* 446 U.S. at 370 n. 14, 100 S.Ct. at 1731 n. 14, they "do not apply elsewhere in the Act of their own force...." *Id.* The parties attempt to garner support for their respective positions from the language in *Nachman.* We conclude that the definition of who is an employer for purposes of determining withdrawal liability under the MPPAA is one that in the final analysis must be left to the courts. *See DeBreceni v. Graf Bros. Leasing, Inc.,* 828 F.2d 877, 880 (1st Cir.1987), *cert. denied,* 484 U.S. 1064, 108 S.Ct. 1024, 98 L.Ed.2d 988 (1988).

Although, as is so often the case, the legislative history of the MPPAA is ambiguous and somewhat contradictory, *see* H.R.Rep. No. 869, 96th Cong., 2d Sess. 60, *reprinted in* 1980 U.S.Code Cong. & Admin.News 2918, 2928, the policies and purposes of the MPPAA are clear, and they fully support the rulings of the district ***1537** court in these cases. The 1980 amendment to ERISA aimed to eliminate the incentive to withdraw from multiemployer plans, and reduced the burdens imposed on plans when employers do withdraw. *See id.* at 2928, 2933 ("The basic policy of the Act is that the retirement income security of multiemployer plan participants is best assured by fostering the growth and continuance of multiemployer plans.... A primary objective of the legislation is to insulate plans to the extent possible from declines, through sounder funding [and] employer withdrawal liability...."). Thus, in deciding how to define employer, the district court properly considered Congress' remedial and protective purposes in enacting the MPPAA, and correctly concluded that the ends sought to be achieved through the Act's passage would best be served by imposing withdrawal liability on Korea and Delta.

[1] In both cases, the trial judges declined to give the term "employer" its common law or dictionary meaning, preferring instead to adopt a definition that more carefully implements the statute's clear objectives. Under this construction, the term employer in 29 U.S.C. § 1381(a) means "a person who is obligated to contribute to a plan either as a direct employer or in the interest of an employer of the plan's participants." *Korea Shipping,* 663 F.Supp. at 770; *see also Delta S.S.,* 688 F.Supp. at 1563-66; *accord In re Uiterwyk Corp.,* 63 B.R. 264 (M.D.Fla.1986). We agree with this definition.

The principal thrust of the carriers' argument on appeal is that it is a fundamental rule that inquiry into the meaning of a statute must begin with its plain meaning, that is, by examining the actual words used by the legislature. The word employer is to be construed in its common law sense which, they contend, is free from doubt. When Congress' term is construed in that fashion, appellants continue, it eliminates the carriers as employers of the longshoremen, and shifts the withdrawal liability to the stevedoring companies. This argument is less convincing than it may at first appear.

Concededly, the best starting point for examining a statute is the language of the statute itself. *Landreth Timber Co. v. Landreth,* 471 U.S. 681, 685, 105 S.Ct. 2297, 2301, 85 L.Ed.2d 692 (1985); *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 756, 95 S.Ct. 1917, 1935, 44 L.Ed.2d 539 (1975) (Powell, J. concurring). Courts generally assume that the ordinary meaning of the language accurately expresses the legislative purpose. *See, e.g., Park 'N Fly, Inc. v. Dollar Park and Fly, Inc.,* 469 U.S. 189, 194, 105 S.Ct. 658, 661, 83 L.Ed.2d 582 (1985). Although inquiry begins with the words, words are not the end of it. *See Massachusetts Bonding & Ins. Co. v. United States,* 352 U.S. 128, 138, 77 S.Ct. 186, 191, 1 L.Ed.2d 189 (1956) (Frankfurter, J. dissenting). As this case illustrates, to adopt the meaning of the word employer appellants urge would open a gaping hole in many multiemployer plans. Such a common law definition of employer would eliminate withdrawal liability for such a significant number of contributors as to threaten those plans' financial viability and potentially make them victims of the precise threat Congress aimed to shield them from when it enacted the MPPAA. *See Korea,* 633 F.Supp. at 769 (quoted in *Delta S.S.,* 688 F.Supp. at 1563).

Rather, it is the task of judges to start with the language of a statute and to reach a judgment that applies that language to a particular set of circumstances in a manner consistent with the statute's stated objectives. The fallacy in the carriers' argument is their failure to recognize that in construing a statute, the task of the courts is to interpret the words of the statute in light of the purposes that animated the lawmakers in enacting it. *See Chapman v. Houston Welfare Rights Org.,* 441 U.S. 600, 608, 99 S.Ct. 1905, 1911, 60 L.Ed.2d 508 (1979). It is in this broader framework that the word employer was properly defined by the district courts as one obliged to contribute to a plan for the benefit of the plan's participants. Such a definition is fully consonant with the MPPAA's objectives.

***1538** B. *Objections to Obligation to Contribute Definition*

The carriers have raised additional objections to the obligation to contribute definition that triggers withdrawal liability. They argue that this standard conflicts with the proscriptions contained in § 302 of the Labor Management Relations Act, 29 U.S.C. § 186 (1982 & Supp. V 1987), which they contend prohibits the carriers from making any payments to the Fund. And, the carriers further claim that a showing of harm to the pension plan is a prerequisite to the imposition of withdrawal liability, that the Fund has failed to demonstrate such harm, and that compelling the carriers to make payments to the Fund constitutes an impermissible windfall. We consider these contentions.

[2] First, § 302(a) of the LMRA provides, in part, that "[i]t shall be unlawful for any employer or association of employers or any person who acts as a labor relations expert, adviser, or consultant to an employer or who acts in the interest of an employer to pay, lend, or deliver, or agree to pay, lend, or deliver, any money or other thing of value" to an employee representative under certain enumerated circumstances. 29 U.S.C. § 186(a). In essence, the carriers urge that the common law definition of employer applies to the LMRA, and again argue that the same definition must also be applied to the MPPAA to avoid a situation in which the same contributions supposedly rendered illegal under § 302 would nonetheless provide the basis for withdrawal liability under the MPPAA.

Nothing in the LMRA supports such a contention. Appellants' argument ignores the provisions of § 302(c)(5) that exempt from the § 302(a) prohibition those contributions "to a trust fund established by [a labor] representative, for the sole and exclusive benefit of the employees of such employer...." 29 U.S.C. § 186(c)(5). Contributions may be made legally to the Fund under the exception carved out by § 302(c)(5). Although the plaintiffs are not the direct employers of the plan's beneficiaries, they did make payments for the employees' benefit to the Fund as members of an association of employers.

In addition, the carriers' argument disregards the policies and purposes of this section of the LMRA which was enacted to guard against corruption in the collective bargaining process through, among other things, the bribery of employee representatives and abuses of power by union officers. *See Arroyo v. United States,* 359 U.S. 419, 425-26, 79 S.Ct. 864, 868, 3 L.Ed.2d 915 (1959). We cannot adopt the carriers' argument that the employees mentioned in § 302(c)(5) must invariably be the payor's own employees. Inasmuch as the entity making the payments described in § 302(a) may simply be one which "acts in the interests of an employer," and because the language of § 302(c)(5) refers to the "employees of such employer," it plainly appears that the beneficiaries of trust funds covered by the exception in § 302(c)(5) need not be direct employees of the payor contemplated in § 302(a).

[3] The carriers' reliance on *Walsh v. Schlecht,* 429 U.S. 401, 97 S.Ct. 679, 50 L.Ed.2d 641 (1977), should give them no comfort. There, the terms of a labor agreement required a contractor to make contributions to a carpenter's trust fund on the basis of the number of hours worked by a non-signatory subcontractor's employees. Although ruling that the contributions did not violate § 302 of the LMRA because the benefits were payable only to employees of signatories to the labor agreement, the Supreme Court also held that payments made "on behalf of" or "for the benefit of" the subcontractor's employees would violate § 302(a) because those employees were not eligible for benefits. *Walsh,* 429 U.S. at 407, 97 S.Ct. at 684. Here, appellants were parties to the agreement that created the Fund, and benefitted from using the labor of the Fund's beneficiaries who were employed by stevedoring companies that were also signatories to the same agreement. *See Delta,* 688 F.2d at 1566 n. 6. Thus, under the present circumstances a carrier may be obligated for withdrawal liability payments to a pension trust fund to benefit eligible employees of another ***1539** employer, even though its own employees are not the benefic aries of that fund. *See, e.g., Spring Branch Mining Co. v. United Mine Workers,* 691 F.Supp. 973, 976-78 (S.D.W.Va.1987), *aff'd,* 854 F.2d 37 (4th Cir.1988) (per curiam), *cert. denied,* 488 U.S. 1019, 109 S.Ct. 817, 102 L.Ed.2d 806 (1989); *Warrior Coal Co. v. Connors,* 649 F.Supp. 1090, 1096-97 (W.D.Va.1986).

[4] Second, the carriers claim that there must be demonstrable harm to the Fund to justify the imposition of withdrawal liability. In light of the MPPAA's policies, and the payments expressly mandated by the statute, there is no unjust enrichment upon receipt of such payments without a showing of harm. This follows because withdrawal liability is designed as a compensatory mechanism to counterbalance shrinkages in the contribution base of covered plans-shrinkages such as those that occurred here when the carriers withdrew from the Port of New York. *See Central States S.E. & S.W. Areas Pension Fund v. Bellmont Trucking Co.,* 788 F.2d 428, 433 (7th Cir.1986). Thus, the Fund need not prove specific harm resulting from the withdrawals; the very act of withdrawal alone suffices because it could well begin the vicious cycle of withdrawals that Congress sought to prevent in enacting the MPPAA. *See Connolly v. Pension Benefit Guaranty Corp.,* 475 U.S. 211, 216, 106 S.Ct. 1018, 1021, 89 L.Ed.2d 166 (1986).

C. *Plaintiffs' Obligation to Contribute*

[5] Having concluded that the contributing obligor definition of employer is appropriate under the MPPAA, we next turn to the issue of whether Korea and Delta have such an obligation. Appellants assert that even using this definition as the test, they cannot be subjected to withdrawal liability because, under their collective bargaining agreements, they have no direct obligation to contribute to the Fund. We disagree.

As noted earlier, in signing the General Cargo Agreement the shippers obligated themselves to pay certain assessments to the NYSA which, in turn, transferred that portion of the assessment monies to be used for pension plan contributions directly to the Fund. Appellants take slightly different tacks in challenging withdrawal liability: Korea asserts that payment of a tonnage assessment was always the *stevedores*' obligation. It argues that Judge Weinfeld's decision was based upon a practice that had developed whereby the carriers paid tonnage assessments directly to the NYSA, and professes disbelief that multi-million dollar questions of withdrawal liability would hinge on “local billing practices.” Delta rechristens the payments it made to the NYSA as being “cargo assessments” and claims that these payments were not obliged contributions to the Fund. Each contend therefore that they had no obligation to contribute to the Fund, and that it is the NYSA which fulfills the obligation to fund the ILA pension plans.

As the Fund correctly points out, the General Cargo Agreement states that “[e]ach vessel carrier ... shall be responsible for an assessment amount per ton on each ton of non-excepted cargo loaded or discharged in the Port of New York,” that those assessments “shall be collected by the direct employer [the stevedores] from each of the carriers and shall be paid to NYSA for immediate transmittal to the NYSA-ILA Fringe Benefits Escrow Fund,” and that “[p]ension payments shall be made by NYSA directly to the NYSA-ILA Pension Trust Fund.” These contractual provisions amply support the conclusion that the stevedores and the NYSA were merely conduits for monies which the carriers were obligated to pay into the longshoremen's pension fund.

The fact that the NYSA was the party that transferred the monies to the Fund is irrelevant. The contributions were received directly from the carriers under the GCA for the express purpose of funding the NYSA-ILA pension plan. We agree with the district courts' observation that to hold that NYSA but not its members must make contributions to the Fund elevates form over substance, and effectively permits contributors to a multiemployer plan to conveniently insulate themselves from withdrawal liability. “The mere existence of an intermediary used to collect and distribute ***1540** the separate contributions of its members does not remove those members from the status of contributors to the plan.” *Korea,* 663 F.Supp. at 771; *see also Delta,* 688 F.Supp. at 1566.

In short, the determination that Korea and Delta were subject to withdrawal liability was firmly bottomed on the express terms of the GCA and clear congressional purpose in enacting the MPPAA's withdrawal liability provisions. To rule otherwise would effectively undermine the very aims and purposes for which the Act came into being.

D. *Proportional Relationship*

[6] Finally, Delta urges that the assessments it paid to the NYSA must bear a proportional relationship to the number of man-hours dedicated to the loading or unloading of its cargo and, absent such proportionality, the amount of the contributions made to the plan through the NYSA cannot serve as the basis for the imposition of withdrawal liability. The statute and the relevant decisional authority are conspicuously silent on this proportionality argument. Congress chose contributions as the basis for allocation of withdrawal liability. It did not regulate the nature or method of those contributions. The method of contribution was left to the parties.

Once the contributions are agreed upon and made, they become the focus by which the withdrawing contributor's share of the plan's unfunded vested benefits pursuant to 29 U.S.C. § 1391 is determined. The structure of wages, assessments, and benefits may not appear wholly rational and consistent. Yet the carriers, the stevedores, and the longshoremen negotiated and agreed upon that structure, and any disproportion between the number of man-hours worked and the tonnage assessments must be deemed to represent the equilibrium that was reached among contending forces in the bitter economic struggle over containerization. In our view the MPPAA simply accepts the parties' contractual arrangement and imposes withdrawal liability upon the party that has assumed an obligation to contribute to the pension fund.

CONCLUSION

In accordance with Judge Leisure's decision in Delta, the parties to that action are directed to proceed with arbitration, initiated by Delta under 29 U.S.C. § 1401, for the purpose of determining the amount of Delta's withdrawal liability. With respect to Korea, appellees claim that this carrier waived its right to arbitration regarding the amount of its withdrawal liability. We are unable on the record before us to determine whether such a waiver has, in fact, occurred and therefore remand that case to the district court for it to make that determination. The judgments are otherwise affirmed.

All Citations

880 F.2d 1531, 1989 A.M.C. 2419, 58 USLW 2091, 113 Lab.Cas. P 11,517, 11 Employee Benefits Cas. 1313

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TAB 77

880 F.2d 1531
United States Court of Appeals,
Second Circuit.

KOREA SHIPPING CORPORATION, Plaintiff-Appellant,
v.
NEW YORK SHIPPING ASSOCIATION-INTERNATIONAL LONGSHOREMEN'S ASSOCIATION PENSION TRUST FUND and the Board of Trustees of the NYSA-ILA Pension Trust Fund, Defendants-Appellees.
DELTA STEAMSHIP LINES, INC., Plaintiff-Appellant,
v.
NEW YORK SHIPPING ASSOCIATION-INTERNATIONAL LONGSHOREMEN'S ASSOCIATION PENSION TRUST FUND, the Board of Trustees of the New York Shipping Association International Longshoremen's Association Pension Trust Fund, Defendants-Counterclaim Plaintiffs-Appellees, Delta Steamship Lines, Inc., Crowley Maritime International (Inc) and Crowley Maritime Corporation, Counterclaim Co-Defendants Appellants.

Nos. 339, 497, Dockets 88-7636, 88-7774.
|
Argued Dec. 5, 1988.
|
Decided July 24, 1989.

Carriers appealed from judgments of the United States District Court for the Southern District of New York, Edward Weinfeld, Kenneth Conboy and Peter K. Leisure, JJ., ruling that they were "employers" under Multiemployer Pension Plan Amendments Act and were subject to withdrawal liability under the Act after ceasing their operations in the Port of New York, 663 F.Supp. 766 and 688 F.Supp. 1560. The Court of Appeals, Cardamone, Circuit Judge, held that: (1) "employer" under Multiemployer Pension Plan Amendments Act means person who is obligated to contribute to the plan either as a direct employer or in the interest of an employer of the plan's participant, and (2) carriers were "employers" subject to withdrawal liability under Act.

Affirmed and remanded.

Attorneys and Law Firms

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Before OAKES, KEARSE and CARDAMONE, Circuit Judges.

Opinion

CARDAMONE, Circuit Judge:

We consider two separate appeals presenting identical legal issues: Whether appellants shipping companies are "employers" under the Multiemployer Pension Plan Amendments Act (MPPAA or the Act), 29 U.S.C. § 1381 *et seq.* (1982), and whether they are therefore subject to "withdrawal liability" under that Act upon ceasing their operations in the Port of New York. The carriers' chief contention is that Congress' use of the term "employer" requires us to construe that word as it is generally understood in the common law, and that under that definition they are not employers for purposes of MPPAA withdrawal liability. On appeal, they argue in effect that the trial courts' wholly different reading of the word employer reinforces the notion that words don't mean what they say but only, as Alice tells us, what we say they mean. *See* L. Carroll, *Alice's Adventures in Wonderland* (London 1865).

Appellant Korea Shipping Corporation (Korea) appeals a grant of summary judgment in favor of defendants, the New York Shipping Association-International Longshoremen's Association Pension Trust Fund (Fund) and its Board of Trustees, that held appellant to be an employer subject to withdrawal liability under the MPPAA. The district court decision, entered on June 25, 1987 by the United States District Court for the Southern District of New York (Weinfeld, J.), reported at 663 F.Supp. 766, was reaffirmed following Judge Weinfeld's death on a motion for reconsideration by Judge Conboy of the Southern District on June 8, 1988. Appellant Delta Steamship Lines (Delta) appeals a similar determination entered on April 5, ***1533** 1988 in the same district court (Leisure, J.), reported at 688 F.Supp. 1560.

These suits were commenced by the carriers as declaratory judgment actions in which they sought rulings that they were not employers under the MPPAA. In both actions, the Fund counterclaimed for the amounts allegedly due as the carriers' withdrawal liabilities. The parties cross-moved for summary judgment on the employer issue in each case, and in both instances the Fund prevailed. The carriers appeal the district court's determinations that as MPPAA employers ceasing operations in the Port of New York they are subject to withdrawal liability. We affirm.

FACTS

A. *Operations at the Port of New York*

The only real dispute between the parties is appellants' status as employers under the MPPAA, and the facts necessary to its resolution are largely agreed upon. To put this issue in proper perspective, it is necessary to examine briefly the unique history of the longshore industry in the Port of New York.

Appellants' vessels called at the Port's marine terminals that are owned and operated by stevedoring companies engaged in the business of loading and unloading ships. A registered pool of longshore employees is available to work the vessels of any carrier; the longshoremen constitute a "floating" work force whose employers change frequently and whose seniority and eligibility for fringe benefits are determined on the basis of their work throughout the Port, not by attachment to any particular company. Carriers provide the work and their ships the workplace. The longshoremen's union negotiates collective bargaining agreements with the stevedoring companies and the carriers that establish the terms and conditions of the longshoremen's employment in the Port.

In litigation concerning whether the Rules on Containers and the work preservation provisions in the longshore contract constituted unlawful secondary activity under §§ 8(b)(4)(B) and 8(e) of the National Labor Relations Act, the carriers were recognized to be longshore employers. *See NLRB v. Int'l Longshoremen's Ass'n,* 447 U.S. 490, 496 n. 10, 100 S.Ct. 2305, 2309 n. 10, 65 L.Ed.2d 289 (1980); *id.* at 499 n. 13, 100 S.Ct. at 2311 n. 13; *id.* at 512, 100 S.Ct. at 2317 (1980); *see* *also NLRB v. Int'l Longshoremen's Ass'n,* 473 U.S. 61, 74 n. 12, 105 S.Ct. 3045, 3053 n. 12, 87 L.Ed.2d 47 (1985). In the Port of New York, the National Labor Relations Board (NLRB) has certified the New York Shipping Association, Inc. (NYSA) as a bargaining unit. Although NYSA's membership consists of carriers, stevedoring companies, carrier agents, and other maritime concerns, the NYSA has historically been under the control of its carrier members.

The obligation for funding the costs of the longshoremen's fringe benefits has been imposed by contract upon the carriers, not on the stevedoring companies. The bitter collective bargaining conflict between the carriers and the International Longshoremen's Association (ILA) sparked by the introduction of containerized methods of cargo handling was finally resolved in 1968 after a lengthy strike and the intervention of a presidential mediator. The labor accord reached required the union to relinquish its demands for limits on containerization in exchange for, among other things, the establishment of a program of enhanced fringe benefits to compensate longshoremen for the effects of the job displacement caused by containerization.

Thus, the advent of containerization and the execution of the 1968 labor contract brought about significant new developments in the carriers' status in the Port of New York. From 1968 to the present the carriers not only continued to negotiate the terms and conditions of longshore employment and the level of longshore employee benefits, but also directly undertook the obligation to pay-and did in fact pay-the contributions necessary to fund these benefits. The key feature of the assessment system in effect in the Port of New York for the past two decades is that the obligation for longshore fringe benefit assessments is placed directly upon the vessel ***1534** carriers based on the tons of cargo loaded and unloaded by longshoremen from their vessels.

Korea and Delta engaged in steamship carrier operations at the Port from 1967 to 1985 and 1978 to 1983 respectively, undertaking a variety of operations which included the loading and unloading of their general cargo and container vessels. Neither company directly employed its own labor force to service its ships, and neither operated its own marine terminal facility. When appellants' ships entered the Port, they called at terminals operated by the stevedoring companies where their vessels loaded and discharged their cargo with the aid of longshoremen directly employed by the stevedoring companies.

B. *Collective Bargaining Agreements*

Operations at the Port are carried out under two collective bargaining agreements-(1) the so-called "master contract," encompassing operations at major ports on the Atlantic and Gulf coasts of the United States, and (2) a local New York labor accord known as the General Cargo Agreement (GCA). The master contract governs the general terms of employment that apply uniformly in eastern ports where the ILA functions. Both agreements were negotiated by the ILA as the representative of the rank and file longshoremen and by the New York Shipping Association and its counterpart organizations in other eastern ports as the representatives of the carriers, the stevedores, and other employers of longshoremen.

The master contract sets uniform terms applicable to ports in which the ILA functions and covers such items as wages, hours, pension and welfare contributions, containerization agreements, and the payment of "job security program assessments" as a means of offsetting shortfalls in contributions to, *inter alia,* longshoremen pension funds. As members of the NYSA, Korea and Delta were parties to the master contract and, in some instances, were also direct signatories. The General Cargo Agreement, also a product of bargaining between the ILA and the NYSA, governs the local terms and conditions of employment in the Port of New York such as pension benefits, seniority, hiring, safety, and holidays. As is the case with the master contracts, plaintiffs are parties to the GCA not only by reason of their membership in the NYSA, but also as direct signatories.

As previously noted, in signing the master contract and the GCA the carriers obligated themselves to pay "job security program assessments" in order to aid in the funding of shortfalls in certain longshore pension, welfare, and trust funds. In addition to these job security program assessments provided for by the master contract, the GCA imposed other cargo assessments in the Port of New York which from 1974 to 1985 were based solely on tonnage and were paid by the carriers to the NYSA. The NYSA, in turn, paid most of those monies to the NYSA-ILA Fringe Benefits Escrow Fund. It transferred directly to the Fund that portion of the assessment monies to be used for pension plan contributions it had collected from its members. The GCA fixed a guaranteed minimum level of total annual contributions that was designed to ensure the availability of adequate funding for future retirement benefits. In relevant part, the GCA provided

> This agreement shall be executed by the ILA for and on behalf of itself and its affiliated Locals and by New York Shipping Association, Inc. for and on behalf of its employer-members and by each contacting stevedore and vessel carrier who directly or indirectly utilizes the services of any employees covered by this agreement and who by such execution binds itself and its successors to each and every term and condition of the agreement, including, without limitation, the contribution of its proportionate share of the hourly, tonnage and other supplemental and fringe benefit contributions provided herein. If any carrier does not subscribe to this and the accompanying JSP Agreements, the ILA shall have the right not to work on the loading and discharging of its ships or any work ancillary thereto.

***1535** *General Cargo Agreement,* October 1, 1980 to September 30, 1983, at 73-74.

In addition, the GCA provided that each carrier would be subject to an assessment calculated according to a predetermined formula based on the tonnage of cargo loaded or discharged by the carrier in the Port. The agreement set forth the procedures for collection and payment of tonnage assessments:

> Such tonnage assessment shall be collected by the direct employer from each of the carriers and shall be paid to the NYSA for immediate transmittal to the NYSA-ILA Fringe Benefits Escrow Fund ... as collected by said direct employers. Pension payment shall be made by the NYSA directly to the NYSA-ILA Pension Trust Fund. Amounts billed to carriers and not collected by the direct employers shall be reported to the NYSA-ILA Fringe Benefits Escrow fund promptly at the end of each billing period.

Id. at 118-19. Thus, though the NYSA made the contributions to the Fund, it received the funds directly from the carriers that had obligated themselves contractually to make the payments. The agreement places the obligation for funding the longshoremen's fringe benefits squarely upon the carriers' shoulders. Moreover, the Fund is administered pursuant to an Agreement and Declaration of Trust and Plan which defines employer as any entity obligated under agreements such as the GCA to pay tonnage assessments.

Throughout the period when Korea and Delta were actively engaged in business in the Port of New York, they were signatories to and active negotiators of the various labor contracts with the ILA. Until their cessation of operations, appellants regularly complied with their assessment obligations under the GCA. Thus, for the five-year period prior to their withdrawal, they paid assessments of $12.5 million and $10 million, respectively, of which approximately $3.5 million and $3 million constituted pension contributions to the Fund. After the two carriers discontinued operations at the Port of New York, the Fund sought to assess withdrawal liability in accordance with the applicable provisions of the MPPAA. Appellants resisted, arguing that the stevedoring companies were the direct employers of the longshoremen, and that it was those companies that would be responsible for withdrawal liability if and when they ceased serving the New York market.

PRIOR PROCEEDINGS

The three district court judges who ruled on the matter concluded that Korea and Delta were employers subject to withdrawal liability under the MPPAA and therefore granted summary judgment in favor of the Fund. Agreeing with the carriers' contentions that they were not the common law employers of the longshoremen, the district court in each case nonetheless found that the issue of employer status under the MPPAA was not governed by the common law definition. Absent an express definition of employer in the MPPAA itself, and without clear guidance from the legislative history, the district judges believed that the determination of how to construe the term employer was derived from assessing the purposes of the legislation. *See NLRB v. Hearst Publications, Inc.,* 322 U.S. 111, 124, 64 S.Ct. 851, 857, 88 L.Ed. 1170 (1944).

Judges Weinfeld and Leisure accordingly adopted a definition of employer that focused on the obligation to contribute to the pension plan and that imposed withdrawal liability upon the party contractually obligated to make those contributions. They observed that the definition of employer set forth in Title I of the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1002(5) (1982 & Supp. V 1987), was not directly applicable to the MPPAA. But the district judges nevertheless drew upon ERISA's definition in holding that the carriers that were contractually obligated to contribute to a plan in the indirect interests of the direct employer (here, the stevedores) could not escape withdrawal liability without threatening "the very effectiveness of the Act." *Korea Shipping,* 663 F.Supp. at 770 (quoted in *Delta S.S.,* 688 F.Supp. at 1566).

***1536** In reaching its determinations, the district court correctly observed that to apply a common law definition of employer to the MPPAA would encourage employers to insulate themselves contractually from liability by entering into agreements under which contributions to the pension plans would be made by entities that were not the direct employers of the plan's beneficiaries. Under such a scenario, the contributing indirect employer could terminate its relationship with the direct employer and thereafter withdraw from the plan without incurring withdrawal liability because, pursuant to the definition of employer urged by appellants, the Act would not be applicable to the contributing indirect employer. At the same time, the direct noncontributing employer would also be absolved of withdrawal liability because it would not be deemed to have "withdraw[n] from a multiemployer plan," 29 U.S.C. § 1381(a), in accordance with the meaning given the term "withdrawal" under the MPPAA. *See* 29 U.S.C. § 1383(a) (defining "withdrawal" as "(1) permanently ceas[ing] to have an obligation to contribute under the plan, or (2) permanently ceas[ing] all covered operations under the plan"). We turn now to analysis of these issues.

DISCUSSION

A. *Definition of Employer*

In enacting ERISA in 1974, 29 U.S.C. § 1001 *et seq.,* Congress sought to prevent the losses suffered by employees and their families when vested pension benefits were not paid because a pension plan was terminated before sufficient funds had been accumulated. *See Pension Benefit Guaranty Corp. v. R.A. Gray & Co.,* 467 U.S. 717, 720, 104 S.Ct. 2709, 2713, 81 L.Ed.2d 601 (1984); *Nachman Corp. v. Pension Benefit Guaranty Corp.,* 446 U.S. 359, 374-75, 100 S.Ct. 1723, 1732-33, 64 L.Ed.2d 354 (1980).

Multiemployer plans developed in industries where job changes are frequent, like longshoring "where workers change employers from day to day or week to week." *NLRB v. Truck Drivers Local Union No. 449,* 353 U.S. 87, 94, 77 S.Ct. 643, 647, 1 L.Ed.2d 676 (1957). Collective bargaining agreements with multiple employers are particularly appropriate in such industries because of the pension protection provided by the pooled funds of many employers. *See Textile*

Workers Pension Fund v. Standard Dye & Finishing Co., 725 F.2d 843, 847 (2d Cir.1984). Subsequent concern for the financial stability of some multiemployer plans prompted Congress, in 1980, to enact that provision of the MPPAA which states: "If an employer withdraws from a multiemployer plan in a complete withdrawal or a partial withdrawal, then the employer is liable to the plan in the amount determined ... to be the withdrawal liability." 29 U.S.C. § 1381(a).

The MPPAA itself contains no definition of the word employer. But Title I of ERISA does contain a definition that would support the Fund's arguments in favor of imposing withdrawal liability upon the carriers, *see* 29 U.S.C. § 1002(5) (defining such status as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan"). Yet, the Supreme Court cautions that though the definitions in Title I "may otherwise reflect the meaning of the terms defined as used in other Titles," *Nachman v. Pension Benefit Guaranty Corp.,* 446 U.S. at 370 n. 14, 100 S.Ct. at 1731 n. 14, they "do not apply elsewhere in the Act of their own force...." *Id.* The parties attempt to garner support for their respective positions from the language in *Nachman.* We conclude that the definition of who is an employer for purposes of determining withdrawal liability under the MPPAA is one that in the final analysis must be left to the courts. *See DeBreceni v. Graf Bros. Leasing, Inc.,* 828 F.2d 877, 880 (1st Cir.1987), *cert. denied,* 484 U.S. 1064, 108 S.Ct. 1024, 98 L.Ed.2d 988 (1988).

Although, as is so often the case, the legislative history of the MPPAA is ambiguous and somewhat contradictory, *see* H.R.Rep. No. 869, 96th Cong., 2d Sess. 60, *reprinted in* 1980 U.S.Code Cong. & Admin.News 2918, 2928, the policies and purposes of the MPPAA are clear, and they fully support the rulings of the district ***1537** court in these cases. The 1980 amendment to ERISA aimed to eliminate the incentive to withdraw from multiemployer plans, and reduced the burdens imposed on plans when employers do withdraw. *See id.* at 2928, 2933 ("The basic policy of the Act is that the retirement income security of multiemployer plan participants is best assured by fostering the growth and continuance of multiemployer plans.... A primary objective of the legislation is to insulate plans to the extent possible from declines, through sounder funding [and] employer withdrawal liability...."). Thus, in deciding how to define employer, the district court properly considered Congress' remedial and protective purposes in enacting the MPPAA, and correctly concluded that the ends sought to be achieved through the Act's passage would best be served by imposing withdrawal liability on Korea and Delta.

[1] In both cases, the trial judges declined to give the term "employer" its common law or dictionary meaning, preferring instead to adopt a definition that more carefully implements the statute's clear objectives. Under this construction, the term employer in 29 U.S.C. § 1381(a) means "a person who is obligated to contribute to a plan either as a direct employer or in the interest of an employer of the plan's participants." *Korea Shipping,* 663 F.Supp. at 770; *see also Delta S.S.,* 688 F.Supp. at 1563-66; *accord In re Uiterwyk Corp.,* 63 B.R. 264 (M.D.Fla.1986). We agree with this definition.

The principal thrust of the carriers' argument on appeal is that it is a fundamental rule that inquiry into the meaning of a statute must begin with its plain meaning, that is, by examining the actual words used by the legislature. The word employer is to be construed in its common law sense which, they contend, is free from doubt. When Congress' term is construed in that fashion, appellants continue, it eliminates the carriers as employers of the longshoremen, and shifts the withdrawal liability to the stevedoring companies. This argument is less convincing than it may at first appear.

Concededly, the best starting point for examining a statute is the language of the statute itself. *Landreth Timber Co. v. Landreth,* 471 U.S. 681, 685, 105 S.Ct. 2297, 2301, 85 L.Ed.2d 692 (1985); *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 756, 95 S.Ct. 1917, 1935, 44 L.Ed.2d 539 (1975) (Powell, J. concurring). Courts generally assume that the ordinary meaning of the language accurately expresses the legislative purpose. *See, e.g., Park 'N Fly, Inc. v. Dollar Park and Fly, Inc.,* 469 U.S. 189, 194, 105 S.Ct. 658, 661, 83 L.Ed.2d 582 (1985). Although inquiry begins with the words, words are not the end of it. *See Massachusetts Bonding & Ins. Co. v. United States,* 352 U.S. 128, 138, 77 S.Ct. 186, 191, 1 L.Ed.2d 189 (1956) (Frankfurter, J. dissenting). As this case illustrates, to adopt the meaning of the word employer appellants urge would open a gaping hole in many multiemployer plans. Such a common law definition of employer would eliminate withdrawal liability for such a significant number of contributors as to threaten those plans' financial viability and potentially make them victims of the precise threat Congress aimed to shield them from when it enacted the MPPAA. *See Korea,* 633 F.Supp. at 769 (quoted in *Delta S.S.,* 688 F.Supp. at 1563).

Rather, it is the task of judges to start with the language of a statute and to reach a judgment that applies that language to a particular set of circumstances in a manner consistent with the statute's stated objectives. The fallacy in the carriers' argument is their failure to recognize that in construing a statute, the task of the courts is to interpret the words of the statute in light of the purposes that animated the lawmakers in enacting it. *See Chapman v. Houston Welfare Rights Org.,* 441 U.S. 600, 608, 99 S.Ct. 1905, 1911, 60 L.Ed.2d 508 (1979). It is in this broader framework that the word employer was properly defined by the district courts as one obliged to contribute to a plan for the benefit of the plan's participants. Such a definition is fully consonant with the MPPAA's objectives.

***1538** B. *Objections to Obligation to Contribute Definition*

The carriers have raised additional objections to the obligation to contribute definition that triggers withdrawal liability. They argue that this standard conflicts with the proscriptions contained in § 302 of the Labor Management Relations Act, 29 U.S.C. § 186 (1982 & Supp. V 1987), which they contend prohibits the carriers from making any payments to the Fund. And, the carriers further claim that a showing of harm to the pension plan is a prerequisite to the imposition of withdrawal liability, that the Fund has failed to demonstrate such harm, and that compelling the carriers to make payments to the Fund constitutes an impermissible windfall. We consider these contentions.

[2] First, § 302(a) of the LMRA provides, in part, that "[i]t shall be unlawful for any employer or association of employers or any person who acts as a labor relations expert, adviser, or consultant to an employer or who acts in the interest of an employer to pay, lend, or deliver, or agree to pay, lend, or deliver, any money or other thing of value" to an employee representative under certain enumerated circumstances. 29 U.S.C. § 186(a). In essence, the carriers urge that the common law definition of employer applies to the LMRA, and again argue that the same definition must also be applied to the MPPAA to avoid a situation in which the same contributions supposedly rendered illegal under § 302 would nonetheless provide the basis for withdrawal liability under the MPPAA.

Nothing in the LMRA supports such a contention. Appellants' argument ignores the provisions of § 302(c)(5) that exempt from the § 302(a) prohibition those contributions "to a trust fund established by [a labor] representative, for the sole and exclusive benefit of the employees of such employer...." 29 U.S.C. § 186(c)(5). Contributions may be made legally to the Fund under the exception carved out by § 302(c)(5). Although the plaintiffs are not the direct employers of the plan's beneficiaries, they did make payments for the employees' benefit to the Fund as members of an association of employers.

In addition, the carriers' argument disregards the policies and purposes of this section of the LMRA which was enacted to guard against corruption in the collective bargaining process through, among other things, the bribery of employee representatives and abuses of power by union officers. *See Arroyo v. United States,* 359 U.S. 419, 425-26, 79 S.Ct. 864, 868, 3 L.Ed.2d 915 (1959). We cannot adopt the carriers' argument that the employees mentioned in § 302(c)(5) must invariably be the payor's own employees. Inasmuch as the entity making the payments described in § 302(a) may simply be one which "acts in the interests of an employer," and because the language of § 302(c)(5) refers to the "employees of such employer," it plainly appears that the beneficiaries of trust funds covered by the exception in § 302(c)(5) need not be direct employees of the payor contemplated in § 302(a).

[3] The carriers' reliance on *Walsh v. Schlecht,* 429 U.S. 401, 97 S.Ct. 679, 50 L.Ed.2d 641 (1977), should give them no comfort. There, the terms of a labor agreement required a contractor to make contributions to a carpenter's trust fund on the basis of the number of hours worked by a non-signatory subcontractor's employees. Although ruling that the contributions did not violate § 302 of the LMRA because the benefits were payable only to employees of signatories to the labor agreement, the Supreme Court also held that payments made "on behalf of" or "for the benefit of" the subcontractor's employees would violate § 302(a) because those employees were not eligible for benefits. *Walsh,* 429 U.S. at 407, 97 S.Ct. at 684. Here, appellants were parties to the agreement that created the Fund, and benefitted from using the labor of the Fund's beneficiaries who were employed by stevedoring companies that were also signatories to the same agreement. *See Delta,* 688 F.2d at 1566 n. 6. Thus, under the present circumstances a carrier may be obligated for withdrawal liability payments to a pension trust fund to benefit eligible employees of another ***1539** employer, even though its own employees are not the benefic aries of that fund. *See, e.g., Spring Branch Mining Co. v. United Mine Workers,* 691 F.Supp. 973, 976-78 (S.D.W.Va.1987), *aff'd,* 854 F.2d 37 (4th Cir.1988) (per curiam), *cert. denied,* 488 U.S. 1019, 109 S.Ct. 817, 102 L.Ed.2d 806 (1989); *Warrior Coal Co. v. Connors,* 649 F.Supp. 1090, 1096-97 (W.D.Va.1986).

[4] Second, the carriers claim that there must be demonstrable harm to the Fund to justify the imposition of withdrawal liability. In light of the MPPAA's policies, and the payments expressly mandated by the statute, there is no unjust enrichment upon receipt of such payments without a showing of harm. This follows because withdrawal liability is designed as a compensatory mechanism to counterbalance shrinkages in the contribution base of covered plans-shrinkages such as those that occurred here when the carriers withdrew from the Port of New York. *See Central States S.E. & S.W. Areas Pension Fund v. Bellmont Trucking Co.,* 788 F.2d 428, 433 (7th Cir.1986). Thus, the Fund need not prove specific harm resulting from the withdrawals; the very act of withdrawal alone suffices because it could well begin the vicious cycle of withdrawals that Congress sought to prevent in enacting the MPPAA. *See Connolly v. Pension Benefit Guaranty Corp.,* 475 U.S. 211, 216, 106 S.Ct. 1018, 1021, 89 L.Ed.2d 166 (1986).

C. *Plaintiffs' Obligation to Contribute*

[5] Having concluded that the contributing obligor definition of employer is appropriate under the MPPAA, we next turn to the issue of whether Korea and Delta have such an obligation. Appellants assert that even using this definition as the test, they cannot be subjected to withdrawal liability because, under their collective bargaining agreements, they have no direct obligation to contribute to the Fund. We disagree.

As noted earlier, in signing the General Cargo Agreement the shippers obligated themselves to pay certain assessments to the NYSA which, in turn, transferred that portion of the assessment monies to be used for pension plan contributions directly to the Fund. Appellants take slightly different tacks in challenging withdrawal liability: Korea asserts that payment of a tonnage assessment was always the *stevedores'* obligation. It argues that Judge Weinfeld's decision was based upon a practice that had developed whereby the carriers paid tonnage assessments directly to the NYSA, and professes disbelief that multi-million dollar questions of withdrawal liability would hinge on “local billing practices.” Delta rechristens the payments it made to the NYSA as being “cargo assessments” and claims that these payments were not obliged contributions to the Fund. Each contend therefore that they had no obligation to contribute to the Fund, and that it is the NYSA which fulfills the obligation to fund the ILA pension plans.

As the Fund correctly points out, the General Cargo Agreement states that “[e]ach vessel carrier ... shall be responsible for an assessment amount per ton on each ton of non-excepted cargo loaded or discharged in the Port of New York,” that those assessments “shall be collected by the direct employer [the stevedores] from each of the carriers and shall be paid to NYSA for immediate transmittal to the NYSA-ILA Fringe Benefits Escrow Fund,” and that “[p]ension payments shall be made by NYSA directly to the NYSA-ILA Pension Trust Fund.” These contractual provisions amply support the conclusion that the stevedores and the NYSA were merely conduits for monies which the carriers were obligated to pay into the longshoremen's pension fund.

The fact that the NYSA was the party that transferred the monies to the Fund is irrelevant. The contributions were received directly from the carriers under the GCA for the express purpose of funding the NYSA-ILA pension plan. We agree with the district courts' observation that to hold that NYSA but not its members must make contributions to the Fund elevates form over substance, and effectively permits contributors to a multiemployer plan to conveniently insulate themselves from withdrawal liability. "The mere existence of an intermediary used to collect and distribute ***1540** the separate contributions of its members does not remove those members from the status of contributors to the plan." *Korea,* 663 F.Supp. at 771; *see also Delta,* 688 F.Supp. at 1566.

In short, the determination that Korea and Delta were subject to withdrawal liability was firmly bottomed on the express terms of the GCA and clear congressional purpose in enacting the MPPAA's withdrawal liability provisions. To rule otherwise would effectively undermine the very aims and purposes for which the Act came into being.

D. *Proportional Relationship*

[6] Finally, Delta urges that the assessments it paid to the NYSA must bear a proportional relationship to the number of man-hours dedicated to the loading or unloading of its cargo and, absent such proportionality, the amount of the contributions made to the plan through the NYSA cannot serve as the basis for the imposition of withdrawal liability. The statute and the relevant decisional authority are conspicuously silent on this proportionality argument. Congress chose contributions as the basis for allocation of withdrawal liability. It did not regulate the nature or method of those contributions. The method of contribution was left to the parties.

Once the contributions are agreed upon and made, they become the focus by which the withdrawing contributor's share of the plan's unfunded vested benefits pursuant to 29 U.S.C. § 1391 is determined. The structure of wages, assessments, and benefits may not appear wholly rational and consistent. Yet the carriers, the stevedores, and the longshoremen negotiated and agreed upon that structure, and any disproportion between the number of man-hours worked and the tonnage assessments must be deemed to represent the equilibrium that was reached among contending forces in the bitter economic struggle over containerization. In our view the MPPAA simply accepts the parties' contractual arrangement and imposes withdrawal liability upon the party that has assumed an obligation to contribute to the pension fund.

CONCLUSION

In accordance with Judge Leisure's decision in Delta, the parties to that action are directed to proceed with arbitration, initiated by Delta under 29 U.S.C. § 1401, for the purpose of determining the amount of Delta's withdrawal liability. With respect to Korea, appellees claim that this carrier waived its right to arbitration regarding the amount of its withdrawal liability. We are unable on the record before us to determine whether such a waiver has, in fact, occurred and therefore remand that case to the district court for it to make that determination. The judgments are otherwise affirmed.

All Citations

880 F.2d 1531, 1989 A.M.C. 2419, 58 USLW 2091, 113 Lab.Cas. P 11,517, 11 Employee Benefits Cas. 1313

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TAB 78

764 F.3d 266
United States Court of Appeals,
Second Circuit.

Ludmila LOGINOVSKAYA, Plaintiff–Appellant,
v.
Oleg BATRATCHENKO, Thor United Corp., Thor United Corp. (Nevis), Thor Asset Management Inc., Thor Real Estate Management LLC, Thor Opti–Max LLC, Thor Capital LLC, Thor Futures LLC, Thor Realty LLC, Thor Guarant Real Estate Fund, Ltd. (BVI), Thor Real Estate Master Fund, Ltd., Thor Optima LLC, Thor Realty Holdings LLC, John Does 1–20, Tatiana Smirnova, Thor Opti–Max Fund, Ltd., Defendants–Appellees.

Docket No. 13–1624–cv.
|
Argued: Jan. 8, 2014.
|
Decided: Sept. 4, 2014.

Synopsis
Background: Investor brought action against members of international financial services organization and its chief executive officer (CEO), alleging violations of Commodity Exchange Act (CEA), and several state law claims sounding in contract law, fraud, and breach of fiduciary duty. The United States District Court for the Southern District of New York, Oetken, J., 936 F.Supp.2d 357, dismissed action for failure to state a claim. Investor appealed.

Holdings: The Court of Appeals, Dennis Jacobs, Circuit Judge, held that:

[1] private right of action brought under CEA was limited to claims alleging commodities transaction within United States, and

[2] neither transfer of title nor point of irrevocable liability for interest in commodity pool occurred in United States.

Affirmed.

Lohier, Circuit Judge, filed dissenting opinion.

Attorneys and Law Firms

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Before: JACOBS, LOHIER and DRONEY, Circuit Judges.

Opinion

Judge LOHIER dissents in a separate opinion.

DENNIS JACOBS, Circuit Judge:

Ludmila Loginovskaya appeals from a judgment of the United States District Court for the Southern District of New York (Oetken, J.), dismissing, pursuant to Fed.R.Civ.P. 12(b)(6), her claims under the Commodity Exchange Act ("CEA"), 7 U.S.C. § 1 *et seq.,* and declining to exercise supplemental jurisdiction over her state law claims. The district court held that the domestic transaction test announced in *Morrison v. National Australia Bank Ltd.,* 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010), applies to Loginovskaya's CEA claim, and that her Amended Complaint failed to adequately allege a domestic transaction. Because the district court dismissed Loginovskaya's only federal claim, it declined to exercise supplemental jurisdiction over her remaining state law claims. On appeal, Loginovskaya argues the district court erred in its application of *Morrison.*

Applying the reasoning of *Morrison,* we agree with the district court that a private right of action brought under CEA § 22 is limited to claims alleging a commodities transaction within the United States. [1] Because Loginovskaya fails to allege a domestic commodities transaction, we affirm the district court's judgment. Because we affirm on the basis of § 22, we do not reach Loginovskaya's argument regarding the territorial reach of the antifraud provision in CEA § 4*o*.

BACKGROUND [2]

The Thor Group, an international financial services organization based in New York, manages investment programs, chiefly in commodities futures and real estate. Among the Thor Group entities are: 1) Thor Guarant, which invests in real estate holdings and development; 2) Thor Optima, which invests in options, futures, securities, and financial instruments; and 3) Thor Opti–Max, which invests in the combined assets of Thor Guarant and Thor Optima. Also part of the Thor Group is Thor United, an entity that maintains "integrated accounts" through which it invests in Thor Guarant, Thor Optima, and Thor Opti–Max on behalf of investors. Several Thor entities are registered participants in the commodities markets as commodity pool operators or commodity trading advisors. Am. Compl., J.A. at 72–73.

Defendant Oleg Batratchenko, a U.S. citizen resident in Moscow, is the Group's chief executive officer; in this role, he is a director for the three Thor programs. Defendant Tatiana Smirnova is a director for the Thor Opti–Max and Thor Guarant programs, and has served in various managerial capacities in the Thor entities.

Loginovskaya, a Russian citizen residing in Russia, was solicited by Batratchenko in January 2006 to invest in the Thor programs. *Id.* at 57. He provided her with brochures, investment memoranda, and other materials, written in Russian, describing the opportunity. *Id.* Batratchenko and his agents represented to her that ***269** she could withdraw her principal and returns at any time upon a set period of notice, that risk would be controlled, that the funds were managed by experienced experts in futures trading and investment (Peter Kambolin and Alexei Chekhlov), and that the programs would be audited regularly by reputable firms. *Id.* at 57–58.

Influenced by these representations, Loginovskaya entered into two investment contracts with Batratchenko and Thor United in 2006 and 2007. These contracts expressly incorporated the investment memoranda earlier provided to Loginovskaya. Pursuant to the contracts, Loginovskaya transferred a total of $720,000 to Thor United's bank accounts in New York, which were subsequently drawn down to a remaining principal of $590,000.

Loginovskaya's account statements over ensuing years generally showed positive returns. Around May 2009, Loginovskaya sought to realize her gains and withdraw her remaining account funds. No money was forthcoming, and no further monthly account statement was dispatched until the statement dated November 2009, which reported for the first time that her investment had lost more than half its value since May. Loginovskaya again requested the return of her funds, unsuccessfully.

Investors were put off with false assurances that the programs were experiencing a temporary dip in liquidity, that cash would be available shortly, and that the Thor programs would be providing detailed financial statements to the investors. An April 2010 letter from Batratchenko falsely contended that, "due to onerous new regulations in the United States, investors could not withdraw their funds from the investment accounts without providing" burdensome documentation. *Id.* at 66 (emphasis omitted).

Since 2010, Loginovskaya has learned that the Thor programs used investors' funds in a manner inconsistent with the investment contracts. Between 2006 and 2009, Batratchenko caused the Thor entities to extend $40 million in unsecured loans to Atlant Capital Holdings LLC. Id. at 67. Atlant, which is not an affiliate of the Thor programs, makes equity investments in commercial and residential property in New York using funds loaned by Thor Real Estate Master Fund, Ltd. Atlant was undercapitalized, its real estate investments failed, the unsecured loans were defaulted, and the Thor entities could not recover Loginovskaya's funds. Batratchenko and Smirnova had personal financial interests in Atlant's real estate activity. *See id.* at 67–70.

This action was commenced in January 2012; the Amended Complaint, filed in June 2012, alleged that the defendants engaged in fraudulent conduct in violation of CEA § 4*o*, and in violation of state law. The district court granted defendants' motion to dismiss the CEA claim under Rule 12(b)(6) for failure to state a cause of action, on the ground that the CEA claim failed *Morrison*'s domestic transaction test. *See Loginovskaya v. Batratchenko,* 936 F.Supp.2d 357, 367–75 (S.D.N.Y.2013). Because Loginovskaya failed to allege a plausible federal cause of action, the court declined to exercise supplemental jurisdiction over her state law claims. *See id.* at 375.

On appeal, Loginovskaya argues the district court erred in applying the *Morrison* test to her CEA claim.

DISCUSSION

"We review *de novo* the grant of a motion to dismiss for failure to state a claim upon which relief can be granted under Federal Rule of Civil Procedure 12(b)(6)." *Harris v. Mills,* 572 F.3d 66, 71 (2d Cir.2009). "We consider the legal sufficiency ***270** of the complaint, taking its factual allegations to be true and drawing all reasonable inferences in the plaintiff's favor." *Id.* " 'To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face.' " *Cohen v. S.A.C. Trading Corp.,* 711 F.3d 353, 359 (2d Cir.2013) (quoting *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009)).

I

[1] The CEA is a "remedial statute that serves the crucial purpose of protecting the innocent individual investor—who may know little about the intricacies and complexities of the commodities market—from being misled or deceived." *Commodity Futures Trading Comm'n v. R.J. Fitzgerald & Co.,* 310 F.3d 1321, 1329 (11th Cir.2002). The CEA contains several anti-fraud provisions to fulfill this purpose. Among those is § 4*o*:

> (1) It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> > (A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or
> >
> > (B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

7 U.S.C. § 6*o*(1) (2008).

A private right of action is afforded by CEA § 22, *see*7 U.S.C. § 25(a)(1), limited to four circumstances, each of them explicitly transactional in nature: receiving trading advice for a fee, making a contract of sale of any commodity for future delivery or the payment of money to make such a contract, placing an order for purchase or sale of a commodity, or market manipulation in connection with a contract for sale of a commodity. *See id.; Klein & Co. Futures, Inc. v. Bd. of Trade of N. Y.,* 464 F.3d 255, 262 (2d Cir.2006) ("Congress enacted CEA § 22 but enumerated the only circumstances under which a civil litigant could assert a private right of action for a violation of the CEA or CFTA regulations."). An aggrieved party otherwise may seek recovery through an administrative proceeding at the Commodity Futures Trading Commission ("CFTC"). *See*7 U.S.C. § 18.

To ascertain the territorial scope of CEA §§ 4*o* and 22, we consult the Supreme Court's opinion in *Morrison,* which decided whether § 10(b) of the Securities Exchange Act of 1934 ("SEA") applies extraterritorially. *See generally* 130 S.Ct. 2869. The *Morrison* Court relied on this canon of statutory construction: " 'unless there is the affirmative intention of the Congress clearly expressed' to give a statute extraterritorial effect, 'we must presume it is primarily concerned with domestic conditions.' " *Id.* at 2877 (quoting *EEOC v. Arabian Am. Oil Co.,* 499 U.S. 244, 248, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991)). Thus, "[w]hen a statute gives no clear indication of an extraterritorial application, it has none." *Id.* at 2878.

Prior to *Morrison,* this Circuit applied an "effects or conducts" test to determine whether SEA § 10(b) applied to transactions outside the United States. *Id.* at 2878–80. The Supreme Court rejected that test as unpredictable and because it neglected the presumption against extraterritoriality: "Rather than guess anew in each case, we apply the presumption in all ***271** cases, preserving a stable background against which Congress can legislate with predictable effects." *Id.* at 2881.

Morrison ascertained the territorial reach of § 10(b) in two steps. First, the Court considered whether Congress, by clear statement, overrode the presumption against extraterritoriality. Courts must presume a statute lacks extraterritorial effect "unless there is the affirmative intention of the Congress clearly expressed." *Id.* at 2877 (quotation marks omitted). The Court held there was no such "affirmative indication in the [SEA] that § 10(b) applies extraterritorially." *Id.* at 2883. The Court observed that references in text to "interstate commerce" or a "national public interest" in the global securities marketplace are insufficient to overcome the presumption. *Id.* at 2882. Moreover, "when a statute provides for *some* extraterritorial application, the presumption against extraterritoriality operates to limit *that provision* to its terms." *Id.* at 2883 (emphasis added).

As *Morrison* acknowledged, the applicability of the presumption at the first step is "not self-evidently dispositive," and "requires further analysis":

> For it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States. But the presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever *some* domestic activity is involved in the case.

Id. at 2884 (emphasis in original). Absent a clear statement by Congress that § 10(b) has extraterritorial effect, *Morrison* proceeded to a second inquiry: how the presumption affects the particular statutory provision in view of the "focus of congressional concern." *Id.* (quotation marks omitted).

As the Court observed, § 10(b) punishes "only deceptive conduct'in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered.' " *Id.* (quoting 15 U.S.C. § 78j(b)). The focus of congressional concern was thus "not upon the place where the deception originated, but upon purchases and sales of securities in the United States." *Id.* Accordingly, the Court limited the territorial scope of SEA § 10(b) to domestic transactions: "purchase[s] or sale[s] ... made in the United States, or involv[ing] a security listed on a domestic exchange." [3] *Id.* at 2886.

The Court expressly rejected an alternative test offered by the Solicitor General that would have weighed whether significant domestic conduct was material to a fraud's success. *Id.* Acknowledging that such a test would have admirable purposes, the Court found no support for it in the statutory text. *Id.* Not incidentally, extension of the territorial reach of the provision would lead to the United States becoming "the Shangri–La of class-action litigation for lawyers representing those allegedly cheated in foreign securities markets."*Id.*

II

The CEA as a whole—and sections 4*o* and 22 in particular—is silent as to extraterritorial reach. [4] *See Starshinova v. Batratchenko,* 931 F.Supp.2d 478, 485–86 (S.D.N.Y.2013) (compiling pre-*Morrison* case law and holding there is no basis to conclude the CEA applies abroad); ***272** *In re LIBOR–Based Fin. Instruments Antitrust Litig.,* 935 F.Supp.2d 666, 696 (S.D.N.Y.2013) (stating no indication of extraterritorial effect in the text of the CEA nor its legislative history). Given the absence of any "affirmative intention" by Congress to give the CEA extraterritorial effect, we must "presume it is primarily concerned with domestic conditions." *Morrison,* 130 S.Ct. at 2877. We therefore proceed to consider the "focus of congressional concern." *Id.* at 2884.

III

[2] Loginovskaya's suit must satisfy the threshold requirement of CEA § 22 before reaching the merits of her § 4*o* fraud claim. In determining *how* the presumption against extraterritorial effect applies, we look to the focus of § 22: domestic conduct, domestic transactions, or some other phenomenon localized to the United States. In § 22, the "focus of congressional concern," *Morrison,* 130 S.Ct. at 2884, is clearly transactional. Section 22 allows a private right of action against a person whose violation of the CEA "result[s] from one or more of the transactions" listed in the statute: receiving trading advice *for a fee;* making a *contract of sale* or deposit in connection with *any order* to make such a contract; the *purchase, sale, or order* for a commodity interest; and market manipulation in connection with a *contract of sale.*7 U.S.C. § 25(a)(1). "The common thread of these four subdivisions is that they limit claims to those of a plaintiff *who actually traded* in the commodities market." *Klein,* 464 F.3d at 260 (emphasis added). Given that CEA § 22 limits the private right to suits over transactions, the suits must be based on transactions occurring in the territory of the United States.

"Traditionally, courts have looked to the securities laws when called upon to interpret similar provisions of the CEA." *Saxe v. E.F. Hutton & Co.,* 789 F.2d 105, 109 (2d Cir.1986). Therefore, *Morrison*'s domestic transaction test in effect decides the territorial reach of CEA § 22. A private right of action exists only when a plaintiff shows that one of the four transactions listed in § 22 occurred within the United States.

Loginovskaya argues that *Morrison* governs substantive (conduct-regulating) provisions rather than procedural provisions such as § 22. *Morrison,* however, draws no such distinction, and holds that the presumption applies generally to "statutes." *See* 130 S.Ct. at 2877–78; 2881. The broad thrust of *Morrison* is actually to the contrary: the majority opinion reins in lower courts that were "disregard[ing] ... the presumption against extraterritoriality" that had been "long and often recited in [Supreme Court] opinions." *Id.* at 2878. *Morrison* thus simplified and reinforced this canon of construction, and thereby discouraged courts from making fussy distinctions in deciding whether or not the presumption applies. Loginovskaya's argument urges us to ignore *Morrison*'s course correction. [5]

Loginovskaya's proposed distinction in this context—between substantive provisions and those that only create a cause of action—is also foreclosed by ***273** *Kiobel v. Royal Dutch Petroleum Co.,* ––– U.S. ––––, 133 S.Ct. 1659, 1665, 185 L.Ed.2d 671 (2013). *Kiobel* applied the presumption against extraterritoriality to the Alien Tort Statute, which "provides district courts with jurisdiction to hear certain claims, but does not expressly provide any causes of action"; "[i]t does not directly regulate conduct or afford relief." *Id.* at 1664. Thus *Kiobel* (like *Morrison*) recognizes that a statutory private right of action reflects congressional choices over the role of the federal courts in adjudicating some claims and not others.

Our reading of CEA § 22 is further consistent with this Court's precedent regarding extraterritoriality. Saying that a private right of action requires a domestic transaction is not the same thing as applying the presumption based on "the identity of the defendant." [6] *Balintulo v. Daimler AG,* 727 F.3d 174, 189–90, n. 24 (2d Cir.2013). Rather, to bring a suit under § 22, the transaction at issue—the conduct underlying the suit—must have occurred within the United States. Moreover, applying a canon of construction equally to all statutory provisions is not the same thing as "improperly conflat[ing] the question whether a statute confers a private right of action with the question whether the statute's substantive prohibition reaches a particular form of conduct." *Gomez–Perez v. Potter,* 553 U.S. 474, 483, 128 S.Ct. 1931, 170 L.Ed.2d 887 (2008).

As Loginovskaya points out, applying *Morrison* to CEA § 22 draws a distinction between private litigation and enforcement actions by the government. Such a result is not remarkable. *See Morrison,* 130 S.Ct. at 2894 n. 12, 2895 (Stevens, J., dissenting) (noting differences between the scope of actions that may be brought by the SEC and those by private parties). This division is consistent with CEA § 4*o*'s apparent focus on the persons who are regulated without regard to where the resulting transaction occurs. *See Alexander v. Sandoval,* 532 U.S. 275, 289, 121 S.Ct. 1511, 149 L.Ed.2d 517 (2001) ("Statutes that focus on the person regulated rather than the individuals protected create no implication of an intent to confer rights on a particular class of persons." (quotation marks omitted)); *see also SEC v. Gruss,* 859 F.Supp.2d 653, 663 (S.D.N.Y.2012). Nor does this distinction (as Loginovskaya contends) set up different substantive standards of conduct based on whether the plaintiff is a private party or the government; the *substantive* standards of § 4*o* are the same regardless of who brings the claim. *See United States v. Vilar,* 729 F.3d 62, 74–75 (2d Cir.2013). Nothing in this opinion precludes relief for a private party in these circumstances; the inability to bring a cause of action in federal court does not restrict the ability to bring a claim before the CFTC. *See*7 U.S.C. § 18(a)(1) ("Any person complaining of any violation of any provision [of the CEA] ... may ... apply to the Commission for an order awarding [damages].").

[3] To summarize, the CEA creates a private right of action for persons anywhere in the world who transact business in the United States, and does not open our courts to people who choose to do business elsewhere.

IV

[4] In the context of SEA § 10(b), we explained that there are two ways to allege a "domestic transaction." *See Absolute Activist,* 677 F.3d at 68. First, "it is sufficient for the plaintiff to allege that title to the [security] was transferred within the United States." *Id.* Second, a plaintiff may allege facts showing "that the parties incurred irrevocable liability within the ***274** United States: that is, that the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security." *Id.*

Given our holding that *Morrison* applies to a private right of action under CEA § 22—and the parallels between the CEA and SEA—there is no reason why *Absolute Activist's* formulation should not apply here. Loginovskaya alleges her claim arises from the purchase, sale, or placing an order for the purchase or sale of an interest or participation in a commodity pool. [7] *See*7 U.S.C. § 25(a)(1)(C)(iii). She must therefore demonstrate that the transfer of title or the point of irrevocable liability for such an interest occurred in the United States.

Loginovskaya argues that the Amended Complaint shows that title to her interest in Thor Opti–Max was transferred in New York. We disagree. Loginovskaya contracted directly with Thor United only. Am. Compl., J.A. at 60. According to the Investment Memoranda incorporated in the contract with Thor United, Thor United invested these assets in the Thor Programs and held them for the benefit of its investors. *See* S.D.N.Y. Dkt. No. 32 Ex. 1B ¶ 3.1. Thus title to the Thor programs was held by Thor United; title was not in the individual investor. *See id.* at J ¶ 5.8. [8] All Loginovskaya purchased was an interest in Thor United. Nowhere does she allege that title to her Thor United shares was transferred within the United States.

Loginovskaya's complaint likewise fails to allege that Thor United incurred irrevocable liability within the United States. At all times, Loginovskaya resided in Russia. Batratchenko solicited her investment while in Russia using investment materials written in Russian. The investment contracts with Thor United were negotiated and signed in Russia. True, Thor United is incorporated in New York; but "a party's residency or citizenship is irrelevant to the location of a given transaction." *Absolute Activist,* 677 F.3d at 70. [9] Russia (not the United States) is where Loginovskaya and the defendants reached a "meeting of the minds." *Id.* at 68; *see also* *Vilar,* 729 F.3d at 77–78 (holding a transaction was domestic because the contract negotiations, ***275** correspondence, and execution occurred in the United States).

Loginovskaya emphasizes that she was required to wire transfer her funds to Thor's bank account in New York. These transfers, however, were actions needed to carry out the transactions, and not the transactions themselves—which were previously entered into when the contracts were executed in Russia. The direction to wire transfer money to the United States is insufficient to demonstrate a domestic transaction. *See* *Vilar,* 729 F.3d at 77 n. 10.

Similarly, the "safe harbor" provisions in the contracts were a part of the larger contract executed in Russia. These provisions permitted Loginovskaya fifteen days to freely withdraw her funds from Thor's New York bank account after her initial transfer. The end of the fifteen-day waiting period, however, was not the start of the transaction. Much like the direction to wire transfer the funds to Thor's New York account, these provisions merely implemented an aspect of a transaction that was executed in Russia.

V

Loginovskaya argues that grafting *Morrison*'s domestic transaction test onto CEA § 22 is anomalous because § 4*o* reaches more broadly. The basis of her argument is that the "focus of congressional concern," *Morrison,* 130 S.Ct. at 2884, in CEA § 4*o* is on domestic commodities market participants—not domestic transactions. The contention that *Morrison*'s transaction test is inapplicable to § 4*o*'s antifraud protection is not without merit. *See* *Loginovskaya,* 936 F.Supp.2d at 369 (observing that "*Morrison*'s transaction test is not immediately applicable to § 4*o*"); *c.f.* CEA § 4*o*, 7 U.S.C. § 6*o* (2008) (protecting against "*prospective* clients or participants" (emphasis added)); *Morrison,* 130 S.Ct. at 2887 (distinguishing the wire fraud statute from SEA § 10(b) because the wire fraud statute has no requirement that the prohibited conduct be " 'in connection with' any particular transaction or event"); *Ebrahimi v. E.F. Hutton & Co.,* 852 F.2d 516, 519 (10th Cir.1988) (noting that CEA § 4b, rather than § 4*o*, is "most closely analogous to the antifraud provision" of SEA § 10(b));

Gruss, 859 F.Supp.2d at 662 (holding that *Morrison*'s transaction test does not apply to Section 206 of the Investment Advisers Act of 1940 because its focus is on the investment advisor). *But see Starshinova,* 931 F.Supp.2d at 486–87. Nevertheless, we do not have to decide how the presumption against extraterritorial effect defines the reach of § 4*o*. Our conclusion that *Morrison*'s domestic transaction test applies to CEA § 22 is not anomalous; if § 4*o* regulates the conduct of domestic commodities market participants in other countries, it would seem Congress has allowed a remedy through the CFTC. *See*7 U.S.C. § 18.

CONCLUSION

While the CEA may reach and regulate the conduct of the Thor defendants, Loginovskaya cannot pursue her cause of action in federal court because: the presumption against extraterritorial effect applies to CEA § 22; that provision requires a commodities transaction; and Loginovskaya has not alleged a domestic commodities transaction. The judgment is affirmed.

LOHIER, Circuit Judge, dissenting:

If we accept her allegations as true, Ludmila Loginovskaya in a sense never had a chance. Enticed by the array of investment opportunities in the vaunted commodities markets of the United States, she was the victim of an old-fashioned fraud that a more perceptive investor, or a ***276** United States regulator, might have identified from a mile away. The main individual perpetrator of the fraud, defendant Oleg Batratchenko, is a United States citizen registered as a "principal" of commodity pool operators and commodity trading advisors under the Commodity Exchange Act ("CEA" or "Act") and a member of the National Futures Association. Most of the Thor corporate defendants are based in the United States and several are registered under the Act as commodity pool operators or commodity trading advisors. At least one of the corporate defendants, Thor Opti–Max Fund, Ltd., is a registered commodity pool.

Batratchenko, as CEO of the Thor Group, first approached Loginovskaya in Moscow in 2006 and, with a series of misrepresentations about the nature of the Thor investment programs, convinced her to invest in the programs by sending nearly $400,000 to an account in New York. A second meeting, and a similar series of misrepresentations, convinced her to cough up another $320,000 investment. The defendants assured Loginovskaya that she could redeem her investment at any time and that the funds in two Thor programs would be invested in commodity futures using particular trading strategies-otherwise, they "would be placed in risk-free U.S. money market accounts when not engaged in such trading"; that a Columbia University professor, described as "highly experienced in futures trading," would manage the investments and conduct regular valuations; and that "[r]eputable international audit firms" were auditing the Thor programs. None of these claims were true, and the defendants unlawfully diverted Loginovskaya's money for their own use in the United States.

My colleagues in the majority will not dispute that the defendants' allegedly fraudulent acts were sufficiently domestic to fall within the scope of CEA § 4*o*, the Act's main antifraud provision, [1] notwithstanding the application of the presumption against extraterritoriality reiterated in *Morrison v. National Australia Bank Ltd.,* 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010). In other words, had Loginovskaya resided on Main Street, U.S.A. or Sutton Place, New York rather than in Surgut, Russia at the time she made her investments, we all agree that her suit would have been allowed to proceed: a large part of the defendants' scheme transpired in the United States, involved United States actors regulated by the CEA, and was premised on false promises to invest Loginovskaya's money in commodities markets in the United States, in violation of § 4*o*. I would start and end the *Morrison* inquiry there, and vacate the decision of the District Court.

Instead, the majority opinion affords an extra, unfounded layer of protection to the defendants by applying the presumption against extraterritoriality and the *Morrison* transaction test to § 22 of the CEA, which authorizes (and limits) private rights of action under the Act but does not regulate ***277** any conduct.[2] Under the rule announced today, private victims of commodities fraud will be required to allege a separate domestic commodities transaction even if they adequately plead a violation of § 4*o*, which does not require such a transaction. In fashioning this new rule, the majority misunderstands both the commodities laws of the United States and the presumption against extraterritoriality. As I explain, the presumption has nothing to do with statutory provisions, like § 22, that merely define *who* may assert a private right of action.

I. *Section 22*

"[The] canon of statutory interpretation known as the presumption against extraterritorial application ... reflects the presumption that United States law governs domestically but does not rule the world." *Kiobel v. Royal Dutch Petroleum Co.,* ––– U.S. ––––, 133 S.Ct. 1659, 1664, 185 L.Ed.2d 671 (2013) (quotation marks omitted). Absent clear congressional intent to the contrary, the presumption limits the application of our statutes regulating conduct to the territory of the United States. Accordingly, we "typically apply the presumption to discern whether an Act of Congress *regulating conduct* applies abroad." *Id.* (emphasis added); *see also Morrison,* 561 U.S. at 266–67, 130 S.Ct. 2869 (focusing on the conduct regulated by § 10(b) of the Securities Exchange Act). But it was never meant to close our courts, as the majority opinion does, to legitimate claims that those laws have been violated.

In my view, *Kiobel,* on which the majority relies, actually endorses the distinction between "substantive provisions and those that only create a cause of action," Majority Op. at 272, and underscores that the presumption applies only to the former. *Kiobel* explains that the jurisdictional grant in the Alien Tort Statute ("ATS") is "best read as having been enacted on the understanding that the common law would provide a cause of action for [a] modest ***278** number of international law violations," *Kiobel,* 133 S.Ct. at 1663 (alteration in original) (quotation marks omitted), while the statute itself permits courts to "craft remedies for the violation of new norms of international law," *id.* at 1664 (quotation marks omitted). Relying on *Kiobel*'s description of the ATS's dual structure as both a jurisdictional grant and a substantive provision of law, we recently clarified that "the presumption against extraterritoriality applies to the *statute,* or at least the part of the ATS that 'carries with it an opportunity to develop common law,' and 'allows federal courts to recognize certain causes of action.' " *Balintulo v. Daimler AG,* 727 F.3d 174, 191 (2d Cir.2013) (emphasis in original) (citations omitted) (quoting *Sosa v. Alvarez–Machain,* 542 U.S. 692, 731 n. 19, 124 S.Ct. 2739, 159 L.Ed.2d 718 (2004), and *Kiobel,* 133 S.Ct. at 1664). In other words, the ATS is a hybrid statute as it pertains to the presumption, in the sense that it both grants jurisdiction for tort claims brought by non-citizens and permits our courts to "engage in common-law development," *id.,* thereby regulating conduct.

As indicated above, unlike § 4*o* and the ATS, § 22 does not purport to regulate conduct, impose liability for particular actions, or define a plaintiff's claims under the CEA. It merely "limit[s] the *categories of persons* that can seek remedies under the statute," *Klein & Co. Futures, Inc. v. Bd. of Trade of the City of N. Y.,* 464 F.3d 255, 260 (2d Cir.2006) (emphasis added), and prescribes who can pursue a private action for violations of substantive provisions of the CEA. To maintain a private cause of action, of course, a private plaintiff must have participated in one or more of the commodities transactions listed in § 22(a)(1). But these transactions are defined in other, substantive provisions of the CEA that prohibit certain types of conduct, and § 22 requires that a private party claim a violation of one of these substantive provisions, like § 4*o*.

Overlooking this distinction and the central question whether § 4*o* reaches the defendants' alleged conduct, the majority opinion insists that the presumption must be applied "equally to all statutory provisions," Majority Op. at 273, and focuses on whether § 22's private right of action applies. This approach both ignores the Supreme Court's caution against "improperly conflat [ing] the question whether a statute confers a private right of action with the question whether the statute's substantive prohibition reaches a particular form of conduct" and leads to "exceedingly strange results." *Gomez–Perez v. Potter,* 553 U.S. 474, 483, 128 S.Ct. 1931, 170 L.Ed.2d 887 (2008).

A simple example illustrates one pitfall of the majority opinion's approach. Consider the jurisdictional statutes at 28 U.S.C. § 1331 and 18 U.S.C. § 3231. Although neither statute expressly rebuts the presumption, we have never dismissed a federal question suit involving actors or conduct abroad on the ground that § 1331 or § 3231 does not apply extraterritorially. Instead, we have consistently considered whether the substantive federal law giving rise to the action (or the prosecution) reaches the conduct in question. For the same reasons, it makes no sense to apply the presumption to § 22 when § 4*o* is the relevant, substantive federal provision that prohibits the defendants' alleged conduct in this case.

The majority opinion's approach also creates two sets of rules that depend solely on the identity of the party seeking to enforce § 4*o*: one for private parties located outside the United States and another for private parties located inside the United States and the Government. Because there was no evidence that Congress intended ***279** it, we rejected a dual regime in *United States v. Vilar,* 729 F.3d 62, 74–75 (2d Cir.2013), *cert. denied,* ––– U.S. ––––, 134 S.Ct. 2684, 189 L.Ed.2d 230 (2014), which involved a criminal prosecution under § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). There we warned against giving "the same statutory text different meanings in different cases" depending on the identity of the party bringing suit. *Id.* at 75. The same simple principle applies here. If a private party located inside the United States—and, as the majority opinion implicitly acknowledges, Majority Op. at 273, the Government—may bring an action to enforce § 4*o* against the Thor defendants for their alleged fraud, then a private plaintiff located outside the United States *a fortiori* may do the same, so long as that plaintiff actually has been injured as a result of a transaction in § 22(a)(1), even if *that* transaction occurred entirely abroad. If the defendants' alleged actions are regulated by § 4*o*, then any party with standing and statutory authority to do so may bring an action to hold them liable.

To dampen the practical if not the legal effects of the problem its holding creates, the majority opinion points to CEA § 14, 7 U.S.C. § 18, a provision that permits private complaints to be made to the Commodity Futures Trading Commission ("CFTC"), the civil government agency tasked with enforcing the Act.[3] *See* Majority Op. at 273 ("[T]he inability to bring a cause of action [such as for fraud under § 4*o*] in federal court does not restrict the ability [of a private plaintiff] to bring a claim before the CFTC."). I share the majority's optimism that the CFTC can effectively police bad behavior. Having announced, however, that "the CEA creates a private right of action for persons anywhere in the world who transact business in the United States, and does not open our courts to people who choose to do business elsewhere," *id.,* the majority cannot have it both ways. If the presumption against extraterritoriality applies equally to *every* statutory provision in the CEA, then it surely applies to § 14 as well. Under the majority's analysis, § 14, which is silent as to its extraterritorial application, would have no greater extraterritorial reach than § 4*o* or, for that matter, § 22, notwithstanding its broad statutory language. *See Kiobel,* 133 S.Ct. at 1665 ("[I]t is well established that generic terms like 'any' or 'every' do not rebut the presumption against extraterritoriality."). Of course, the majority's instinct is entirely correct: foreign private plaintiffs harmed by fraudulent commodities transactions in violation of § 4*o should* have an avenue of relief. In my view, that avenue includes both § 14 and § 22, neither of which purports to regulate conduct and, therefore, neither of which is subject to the presumption.

II. *Section 4o*

As the District Court put it, "to hold that *Morrison*'s presumption against extraterritoriality applies [to § 4*o*] is quite different from grafting *[Morrison*'s*]* transaction test onto a statutory provision whose plain language appears to resist such an interpretation." *Loginovskaya v. Batratchenko,* 936 F.Supp.2d 357, 369 (S.D.N.Y.2013). Lest there be any doubt, and even though the majority agrees with me on this point, I want to explain briefly ***280** why *Morrison*'s transaction test does not apply to § 4*o* and Loginovskaya's allegations suffice to state a claim under that provision.

By its terms, § 4*o* does not *demand* that a transaction occur; it prohibits "fraud *simpliciter,* without any requirement that it be 'in connection with' any particular transaction or event." *Morrison,* 561 U.S. at 271–72, 130 S.Ct. 2869 (discussing a similarly worded provision of the federal wire fraud statute, 18 U.S.C. § 1343). It broadly forbids the use of any "device, scheme, or artifice to defraud" by any United States-registered commodity trading advisor, commodity pool operator, or associated person, whether or not that use culminates in a commodities transaction. So in addition to fraudulent transactions, § 4*o* prohibits "any ... *practice, or course of business* which operates as a fraud or deceit" and includes frauds against "prospective" clients, which obviously do not involve a transaction.[4]

Loginovskaya has sufficiently alleged a violation of § 4*o*. In arriving at this conclusion I am guided by the Supreme Court's interpretation of similarly structured statutes. For example, faced with a challenge to the extraterritorial application of the wire fraud statute in *Pasquantino v. United States,* 544 U.S. 349, 125 S.Ct. 1766, 161 L.Ed.2d 619 (2005), the Court held that the petitioners' offense "was complete the moment they executed the scheme inside the United States" and that the locus of the petitioners' conduct in the United States provided the necessary "domestic element" that the wire fraud statute prescribed. *Id.* at 371, 125 S.Ct. 1766. The Thor defendants' alleged "scheme or artifice to defraud" in violation of § 4*o* likewise was complete at least as soon as they diverted Loginovskaya's funds in New York. Loginovskaya alleges that their deceptive scheme was executed in part in the United States because the defendants issued investment memoranda and correspondence regarding the Thor programs from New York, Loginovskaya wired her investment funds to New York bank accounts, account statements were generated in New York, and the unauthorized investments occurred in the United States. *See* Joint App'x 49–50, 56, 74–75. These allegations, taken together, satisfy the territoriality requirement under § 4*o*.

This result—one the majority should have reached—reflects the expansive purpose of the CEA, which expressly aims to "protect *all* market participants from fraudulent or other abusive sales practices and misuses of customer assets," and to preserve the integrity of the United States commodities markets. *See*7 U.S.C. § 5 (emphasis added). Particularly when a vast amount of investment in the United States commodities markets emanates from abroad, including sovereign wealth funds, "all market participants" must mean all, without restriction to participants who engage in domestic transactions. The legislative history of the Act confirms that its "fundamental purpose ... is to insure fair practice and honest dealing on the commodity exchanges," ***281** S.Rep. No. 93–1131, at 1, 14 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5843, 5844, 5856, and to encourage commodity pool operators, trading advisors, and other CEA-registered entities to engage in honest dealing that reflects well on the commodities markets, S.Rep. No. 95–850, at 12–13 (1978), *reprinted in* 1978 U.S.C.C.A.N. 2087, 2101 (discussing the trend in federal regulation toward "encouraging honest and sound dealing and strengthening public confidence in the nation's rapidly expanding futures markets"). Similarly, § 4*l* of the Act states that "the activities of commodity trading advisors and commodity pool operators are affected with a national public interest." 7 U.S.C. § 6*l*. The Act's primary focus is on the regulated commodity entities-the market's ambassadors of sorts-not on individual transactions.

For these reasons I respectfully dissent.

All Citations

764 F.3d 266

Footnotes

[1] *See infra* footnote 4.

[2] The following facts are derived entirely from the plaintiff's Amended Complaint, which we presume to be true at this stage of the proceeding. *See, e.g., Dejesus v. HF Mgmt. Servs., LLC,* 726 F.3d 85, 87 (2d Cir.2013).

[3] *Morrison* did not further define a domestic transaction. This Circuit addressed that issue in *Absolute Activist Value Master Fund Ltd. v. Ficeto. See generally* 677 F.3d 60 (2d Cir.2012).

[4] The Dodd-Frank: Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Pub. L. No. 111-203. 124 Stat. 1376 (2010), amended CEA § 22 to cover swaps, and provided that its "provisions ... relating to swaps" may, under certain

circumstances, "apply to activities outside the United States." 7 U.S.C. § 25(a)(1) (2010); id. § 2(i). The Court takes no view of the effect that the Dodd-Frank amendments may have on the extraterritorial reach of the CEA: no swaps or transactions involving swaps are at issue here.

5 In *Blazevska v. Raytheon Aircraft Co.*, the Ninth Circuit decided whether the presumption against extraterritorial effect applied to a procedural statute that "only regulates the ability of a party to seek compensation from ... airplane manufacturers in American courts." 522 F.3d 948, 953 (2008). Because the statute was merely procedural and "not a statute governing the substantive standards involved in tort claims," *id.* at 953, the court held that the presumption did not apply, *id.* at 954–55. *Blazevska*, however, was decided prior to *Morrison* and, therefore, carries little (if any) clout.

6 *Pace* the dissent.

7 Loginovskaya's Amended complaint also alleges she received trading advice for a fee. *See*7 U.S.C. § 25(a)(1)(A). As the district court observed, however, there are no allegations in the complaint of Loginovskaya receiving trading advice. *See* 936 F.Supp.2d at 373. We therefore consider only her allegations regarding the purchase or sale of an interest in a commodity pool.

8 Although the Investment Memoranda are not part of the complaint, we may consider documents which the complaint incorporates by reference or relies heavily upon. *See, e.g., DiFolco v. MSNBC Cable L.L.C.,* 622 F.3d 104, 111 (2d Cir.2010). Loginovskaya acknowledges that her complaint incorporates the Investment Memoranda by reference, though she does not concede the accuracy of the translations. Appellant Br. at 14, n.47. Even if we did not rely on the Investment Memoranda, however, the only plausible inference permitted by the complaint is that Loginovskaya invested in Thor United and gave Thor United discretion over her investment.

9 Loginovskaya attempts to distinguish this portion of *Absolute Activist* by pointing out that the residency or citizenship of natural persons is different from corporate entities. *See* Appellant Br. at 60, n.185. She argues that, although natural persons can be physically present in a jurisdiction other than where they are resident, a corporation is only located in the jurisdiction where it exists as a creature of law. Taken to its logical conclusion, any transaction with a United States corporation would constitute a domestic transaction. We reject this argument because it would expand *Morrison*'s transaction test beyond the scope of the "conduct and effects" test with which *Morrison* dispensed.

1 Section 4*o* provides, in relevant part:

> (1) It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> (A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or
>
> (B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

7 U.S.C. § 6*o*.

2 Section 22 provides, in relevant part:

> (1) Any person (other than a registered entity or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person—
>
> (A) who received trading advice from such person for a fee;
>
> (B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity) or any swap; or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract or any swap;
>
> (C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of-
>
> (i) an option subject to section 6c of this title (other than an option purchased or sold on a registered entity or other board of trade);
>
> (ii) a contract subject to section 23 of this title; or
>
> (iii) an interest or participation in a commodity pool; or
>
> (iv) a swap; or
>
> (D) who purchased or sold a contract referred to in subparagraph (B) hereof or swap if the violation constitutes—
>
> (i) the use or employment of, or an attempt to use or employ, in connection with a swap, or a contract of sale of a commodity, in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative device or contrivance in contravention of such rules and regulations as the Commission shall promulgate by not later than 1 year after July 21, 2010; or

> (ii) a manipulation of the price of any such contract or swap or the price of the commodity underlying such contract or swap.

7 U.S.C. § 25(a)(1).

[3] CEA § 14 provides, in relevant part: "Any person complaining of any violation of any provision of this chapter, or any rule, regulation, or order issued pursuant to this chapter, by any person who is registered under this chapter may, at any time within two years after the cause of action accrues, apply to the Commission for an order awarding [damages]." 7 U.S.C. § 18(a)(1).

[4] By contrast, the language of § 4b of the Act, 7 U.S.C. § 6b, mirrors the relevant transaction-focused text of § 10(b) of the Securities Exchange Act. *Compare*7 U.S.C. § 6b(a) (targeting fraudulent conduct "in connection with any order to make, or the making of, any contract of sale of any commodity"), *with*15 U.S.C. § 78j(b) (targeting the use of any manipulative or deceptive device "in connection with the purchase or sale of any security registered on a national securities exchange"). In view of § 4b's limitation to frauds that are "in connection with" a commodities transaction, the District Court's decision might have made sense had Loginovskaya brought her claim under § 4b rather than § 4*o*.

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TAB 79

770 F.3d 170
United States Court of Appeals,
Second Circuit.

Saadya MASTAFA, Kafia Ismail, Batul Nur, Afaf Rasool, Zahra Rasool, Plaintiffs–Appellants,
v.
CHEVRON CORPORATION, Banque Nationale de Paris Paribas, Defendants–Appellees.

No. 10–5258–cv.
|
Submitted: May 28, 2014.
|
Decided: Oct. 23, 2014.

Synopsis
Background: Alleged victims of human rights abuses in Iraq brought action, under the Torture Victims Protection Act (TVPA) and Alien Tort Statute (ATS), against oil company and French bank alleged to have aided the regime of Saddam Hussein in obtaining income in violation of the United Nations Oil-for-Food Program. The United States District Court for the Southern District of New York, Jed S. Rakoff, J., 759 F.Supp.2d 297, granted defendants' motion to dismiss. Victims appealed.

Holdings: The Court of Appeals, José A. Cabranes, Circuit Judge, held that:

[1] company and bank were not subject to liability under the TVPA;

[2] allegations were sufficient to plead violations of customary international law;

[3] as a matter of first impression in the circuit, in determining whether a claim sufficiently "touches and concerns" the United States as to displace presumption against extraterritorial application, a court must isolate relevant conduct, determine whether that conduct states claim for violation of the law of nations, and determine, if the claim is for aiding and abetting, whether the conduct purposely advanced human rights abuses;

[4] allegations were sufficient to plead conduct that touched and concerned the United States; and

[5] allegations were insufficient to plead bank and company acted with purpose of facilitating human rights abuses.

Affirmed.

Attorneys and Law Firms

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Terrence Patrick Collingsworth, Conrad & Scherer, LLP, Washington, D.C., for amicus curiae Human Rights Watch and Labor Organizations.

Before: CABRANES, STRAUB, and LIVINGSTON, Circuit Judges.

Opinion

JOSÉ A. CABRANES, Circuit Judge:

The question presented is whether the United States District Court for the Southern District of New York (Jed S. Rakoff, *Judge*) properly dismissed the complaint of five Iraqi nationals who claim that they and their family members were tortured, imprisoned, and in some cases executed, by the Saddam Hussein regime. Plaintiffs filed suit in July 2010 against defendants Chevron Corp. and Banque Nationale de Paris Paribas ("BNP") (jointly, "defendants"), alleging that defendants illicitly diverted money to the Saddam Hussein regime—then subject to economic sanctions—in violation of customary international law. Plaintiffs contend on appeal that such harms are cognizable under the Alien Tort Statute of 1789 ("ATS"), 28 U.S.C. § 1350, which establishes district court jurisdiction "of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States," as well as the Torture Victim Protection Act of 1991 ("TVPA"), 28 U.S.C. § 1350 note, and New York common law. The District Court entered judgment on November 30, 2010, dismissing plaintiffs' complaint with prejudice under Federal Rules of Civil Procedure 12(b)(1) and (6).

The parties agree, and we hold, that the Supreme Court's decision in *Mohamad v. Palestinian Authority,* ––– U.S. ––––, 132 S.Ct. 1702, 182 L.Ed.2d 720 (2012), indisputably forecloses plaintiffs' claims brought under the TVPA. We also conclude, in a question of first impression for this Court, that we do not have jurisdiction over plaintiffs' ATS claims pursuant to the Supreme Court's decision in *Kiobel v. Royal Dutch Petroleum Co.,* ––– U.S. ––––, 133 S.Ct. 1659, 185 L.Ed.2d 671 (2013), and our holding in *Presbyterian Church of Sudan v. Talisman Energy, Inc.,* 582 F.3d 244 (2d Cir.2009). Accordingly, we AFFIRM the judgment of the District Court.

BACKGROUND

I. The Complaint

Plaintiffs in this action are Iraqi women who were the victims of torture by agents ***175** of the Saddam Hussein regime or whose husbands were the victims of such torture. Two plaintiffs are Kurdish women currently living in Iraq, and the remaining three plaintiffs were citizens of Iraq at the time of the alleged torture but are now either citizens or permanent residents of the United States.[1] Plaintiffs filed the instant case on July 26, 2010, seeking, *inter alia,* compensatory and punitive damages on their own behalf and as a putative class action on behalf of those similarly situated. They claim that the defendant corporations aided and abetted the abuses of the Saddam Hussein regime by paying the regime kickbacks and other unlawful payments, which enabled the regime to survive and perpetrate the abuses suffered by plaintiffs or their husbands.

The allegations against defendants stem from the United Nations' Oil for Food Programme ("OFP"). The OFP "permitted the export of oil from Iraq in exchange for food, medicine, and other basic civilian necessities" by allowing the purchase of Iraqi oil to proceed through an escrow account, into which purchasers submitted payments and from which providers of civilian necessities received payment. *Mastafa v. Chevron Corp.,* 759 F.Supp.2d 297, 298–99 (S.D.N.Y.2010). Plaintiffs allege that the Saddam Hussein regime—then subject to United Nations economic sanctions—misused the

OFP in order to “[e]licit income outside the United Nation[s'] oversight and fund its regime.... [and] to fund its campaign of human rights abuses against its people.” Compl. ¶¶ 33–34.

The misuse occurred when the Iraqi regime began imposing illegal “surcharges” of 10 to 30 cents per barrel on oil being lawfully sold by Iraq pursuant to the OFP. The complaint alleges that this surcharge was known to all “contracting customers” of the Saddam Hussein regime, including Chevron—which is alleged to have knowingly paid the illegal surcharge on 9,533,690 barrels of oil. *Id.* ¶¶ 37–41. The complaint alleges that Chevron “acted as a financer to many ... oil contracts,” *id.* ¶ 58, and that, in doing so, Chevron “made surcharge payments, facilitated surcharge payments and participated in surcharge payments in order to purchase oil from Iraq through the [OFP],” *id.* ¶ 72. Chevron allegedly “paid $20 million in [illicit] surcharge payments ... through third parties,” and “knew that the premiums it paid to the third party were passed through to the Saddam Hussein regime as a requirement to purchase oil.” *Id.* ¶¶ 83–84.

With respect to BNP, the complaint alleges that, pursuant to a Banking Agreement between BNP and the United Nations, BNP was the sole escrow bank for the OFP and was responsible for policing financial transactions associated with it. Under the Banking Agreement, one of BNP's roles as escrow agent for the United Nations was to ensure that financial transactions were in compliance with the United Nations Security Council resolutions that had created the program. Plaintiffs assert that, notwithstanding this obligation under the Banking Agreement, “BNP knew that the true nature of the financial transactions included illicit payments to the [Saddam Hussein] Regime and failed to disclose or interrupt the payments.” *Id.* ¶ 107. Plaintiffs further allege ***176** that “[s]ome of the surcharges were paid by BNP through customer accounts,” *id.* ¶ 70, and that in at least one transaction, BNP “hid the identity of oil financiers as participants in an oil transaction” in violation of the Banking Agreement, *id.* ¶ 125.

There is no allegation by plaintiffs that Chevron or BNP, or their employees, directly engaged in the human rights abuses allegedly committed by the Saddam Hussein regime. Rather, plaintiffs allege that “[t]hese surcharge payments financed the torture” and other atrocities inflicted on them or their husbands, which required considerable funding. *Id.* ¶ 45. Plaintiffs contend that, through these alleged exploitations of the OFP, Chevron and BNP aided and abetted the Saddam Hussein regime's abuses, and that their claims are therefore actionable under the ATS and the TVPA.

II. Procedural History

On November 30, 2010, the District Court entered judgment dismissing plaintiffs' complaint with prejudice. The dismissal was based on the District Court's conclusions that (1) the ATS claims were barred by the Second Circuit's opinion in *Kiobel v. Royal Dutch Petroleum Co.,* 621 F.3d 111 (2d Cir.2010), which held that the ATS does not confer jurisdiction for claims alleging violations of the “law of nations” (that is, customary international law[2]) against corporate defendants; (2) plaintiffs had failed adequately to plead negligence under state law, and other state law claims were time-barred; and (3) there were various pleading deficiencies in their TVPA claim.

Plaintiffs timely appealed, and filed their initial briefs in this appeal between April and July 2011. Plaintiffs initially asserted a number of arguments, including that the ATS and TVPA allowed for corporate liability, that claims could be brought against alleged “aiders and abettors” under the TVPA, and that they had met other pleading requirements necessary to state a claim under the TVPA.

After the Supreme Court granted *certiorari* in *Kiobel,* ––– U.S. ––––, 132 S.Ct. 472, 181 L.Ed.2d 292 (2011), plaintiffs here moved on October 21, 2011, to stay the appeal pending the Supreme Court's adjudication of the case. We granted the motion on October 25, 2011.

Following oral argument in *Kiobel,* the Supreme Court, on March 5, 2012, ordered supplemental briefing and reargument on “[w]hether and under what circumstances the Alien Tort Statute ... allows courts to recognize a cause of action for violations of the law of nations occurring within the territory of a sovereign other than the United States.” ––– U.S.

––––, 132 S.Ct. 1738, 182 L.Ed.2d 270 (2012) (internal quotation marks omitted). In April 2013, the ***177** Supreme Court issued its decision in *Kiobel,* ––– U.S. ––––, 133 S.Ct. 1659, 185 L.Ed.2d 671 (2013), holding that "the presumption against extraterritoriality applies to claims under the ATS ... and case[s] seeking relief for violations of the law of nations occurring outside the United States [are] barred." *Id.* at 1669. It did not address, much less question or modify, the holding on corporate liability under the ATS that had formed the central conclusion in the Second Circuit's *Kiobel* opinion.

Additionally, during the pendency of the stay here, the Supreme Court decided another case with direct relevance to this action. In *Mohamad v. Palestinian Authority,* ––– U.S. ––––, 132 S.Ct. 1702, 182 L.Ed.2d 720 (2012), the Court held that the TVPA "authorizes liability solely against natural persons," *id.* at 1708, and "does not impose liability against organizations," including corporations, *id.* at 1705.

On March 28, 2014, we vacated the stay of this appeal, and ordered supplemental letter briefs from the parties on the effect, if any, of the Supreme Court's decisions in *Kiobel* and *Mohamad.*

The supplemental briefing having been completed, we now conclude that the District Court properly dismissed the claims brought pursuant to the TVPA and ATS. [3]

DISCUSSION

In reviewing a district court's determination of subject matter jurisdiction pursuant to Federal Rule of Civil Procedure 12(b)(1), we review legal conclusions *de novo* and factual findings for clear error. *Tandon v. Captain's Cove Marina of Bridgeport, Inc.,* 752 F.3d 239, 243 (2d Cir.2014). A case is properly dismissed for lack of subject matter jurisdiction under Rule 12(b)(1) when the district court "lacks the statutory or constitutional power to adjudicate it." *Makarova v. United States,* 201 F.3d 110, 113 (2d Cir.2000). "A plaintiff asserting subject matter jurisdiction has the burden of proving by a preponderance of the evidence that it exists." *Id.*

We review *de novo* a district court's dismissal pursuant to Federal Rule of Civil Procedure 12(b)(6), accepting all factual allegations in the complaint as true. *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG,* 752 F.3d 173, 179 (2d Cir.2014). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' " *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 570, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). "[A]lthough a court must accept as true all of the allegations contained in a complaint, that tenet is inapplicable to legal conclusions, and threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Harris v. Mills,* 572 F.3d 66, 72 (2d Cir.2009) (internal quotation marks omitted). "Determining whether a complaint states a plausible claim for relief will be a context-specific task that requires the reviewing court to draw on its judicial experience and common sense." *Id.* (alterations omitted).

I. The TVPA Claims

[1] The TVPA imposes liability on "[a]n *individual* who, under actual or apparent authority, or color of law, of any ***178** foreign nation" subjects another individual to torture or extrajudicial killing. 28 U.S.C. § 1350 note § (2)(a) (emphasis supplied). Plaintiffs in *Mohamad* argued that the word "individual" in the statute encompassed both natural persons and "nonsovereign organizations," including the political organization that was the defendant in that action. *Mohamad,* 132 S.Ct. at 1706. The Supreme Court disagreed, holding that the term "individual" in the TVPA "authorizes suit against natural persons alone." *Id.* The Court also expressly stated that the statute does not provide for suits against corporate entities, noting that "it is the rare statute ... in which Congress expressly defines 'individual' to include corporate entities," and that "[t]here are no such indications in the TVPA." *Id.* at 1707.

There is no dispute that the defendants in this action are corporations, and therefore we are required to hold that they are not subject to liability under the TVPA. Plaintiffs acknowledge this point, conceding in their supplemental brief that "Chevron and BNP cannot be liable pursuant to the TVPA under the current state of the law." Appellants' Ltr. Br. 2. Accordingly, we affirm the Rule 12(b)(6) dismissal of the claims brought pursuant to the TVPA.

II. The ATS Claims

[2] **[3]** The ATS states, in full: "The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." 28 U.S.C. § 1350. It is a "jurisdictional" statute in the sense that it "address[es] the power of the courts to entertain cases concerned with a certain subject." *Sosa v. Alvarez–Machain,* 542 U.S. 692, 714, 124 S.Ct. 2739, 159 L.Ed.2d 718 (2004). Although it reads as a "jurisdictional grant" only, the Supreme Court has held that the ATS was "enacted on the understanding that the common law would provide a cause of action for the modest number of international law violations with a potential for personal liability at the time." *Id.* at 724. As Judge Friendly has explained, the ATS's "reference to the law of nations must be narrowly read if the section is to be kept within the confines of Article III." *IIT v. Vencap, Ltd.,* 519 F.2d 1001, 1015 (2d Cir.1975) (Friendly, J.), *abrogated on other grounds, Morrison v. Nat'l Austl. Bank Ltd.,* 561 U.S. 247, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010). Thus, although there are billions of people in the world residing under various forms of state-sponsored oppression, claims are only actionable under the ATS if they are "accepted by the civilized world and defined with a specificity comparable to the features of the 18th-century paradigms" upon which the ATS was written in 1789. *Sosa,* 542 U.S. at 725.[4]

Defendants assert numerous grounds upon which we might affirm the dismissal of plaintiffs' ATS claims, including that (1) defendants are corporations, and therefore not subject to ATS liability pursuant to the ***179** Second Circuit's holding in *Kiobel;* (2) plaintiffs have failed to state a claim for aiding and abetting violations of the law of nations; and (3) the Supreme Court's decision in *Kiobel* forecloses our jurisdiction over cases such as this one, where the claims do not sufficiently "touch and concern" the United States. *See* Chevron's Ltr. Br.; BNP's Ltr. Br.

[4] **[5]** It is natural for us to begin with the question of our subject-matter jurisdiction, which "functions as a restriction on federal power." *Ins. Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinee,* 456 U.S. 694, 702, 102 S.Ct. 2099, 72 L.Ed.2d 492 (1982). " 'Without jurisdiction the court cannot proceed at all in any cause'; it may not assume jurisdiction for the purpose of deciding the merits of the case." *Sinochem Int'l Co. v. Malaysia Int'l Shipping Corp.,* 549 U.S. 422, 431, 127 S.Ct. 1184, 167 L.Ed.2d 15 (2007) (quoting *Steel Co. v. Citizens for a Better Env't,* 523 U.S. 83, 94, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998)). Indeed, "[b]ecause of the primacy of jurisdiction, 'jurisdictional questions ordinarily must precede merits determinations in dispositional order.' " *Frontera Res. Azerbaijan Corp. v. State Oil Co. of Azerbaijan Republic,* 582 F.3d 393, 397 (2d Cir.2009) (quoting *Sinochem,* 549 U.S. at 431, 127 S.Ct. 1184); *see also Cardona v. Chiquita Brands Int'l, Inc.,* 760 F.3d 1185, 1188 (11th Cir.2014) (addressing the question of jurisdiction under the ATS, rather than the substantive question that had been certified, because, "no matter how a case comes before us, the court has the authority and the duty to determine its own jurisdiction").

[6] **[7]** Here, then, we begin by assessing whether the ATS grants us jurisdiction over plaintiffs' action. In light of the singular character of the ATS as a jurisdictional statute that derives its substantive meaning from customary international law, there are numerous jurisdictional predicates, all of which must be met before a court may properly assume jurisdiction over an ATS claim. For a district court, these jurisdictional inquiries include, but may not be limited to, a determination that: (1) the complaint pleads a violation of the law of nations, *see Sosa,* 542 U.S. at 732, 124 S.Ct. 2739; *Kadic v. Karadzic,* 70 F.3d 232, 238 (2d Cir.1995); (2) the presumption against the extraterritorial application of the ATS, announced by the Supreme Court in *Kiobel,* 133 S.Ct. 1659, does not bar the claim; (3) customary international law recognizes liability for the defendant, *see Kiobel,* 621 F.3d at 145; and (4) the theory of liability alleged by plaintiffs (*i.e.,* aiding and abetting, conspiracy) is recognized by customary international law, *see Khulumani v. Barclay National Bank Ltd.,* 504 F.3d 254, 264 (2d Cir.2007) (Katzmann, J., concurring). Although each of these requires an affirmative determination before a court properly has jurisdiction over an ATS claim, the order and manner in which a court undertakes these inquiries is a matter of discretion based upon the particular circumstances presented. Here, in the circumstances before us, we begin with an inquiry into whether plaintiffs pleaded a violation of the law of nations, we then examine the theory of liability asserted, and we finally address extraterritoriality. Because we conclude that the complaint is barred by the presumption against extraterritoriality, we need not conclusively address other jurisdictional predicates. [5]

*180 A. Pleading a Violation of the Law of Nations

[8] **[9]** The first jurisdictional inquiry that we undertake is determining whether plaintiffs have adequately pleaded a cause of action. The ATS only confers jurisdiction over torts based upon violations of United States treaties or of the law of nations. 28 U.S.C. § 1350. As Judge Jon O. Newman has explained, "[b]ecause the [ATS] requires that plaintiffs plead a violation of the law of nations at the jurisdictional threshold, this statute requires a more searching review of the merits to establish jurisdiction than is required under the more flexible 'arising under' formula of [28 U.S.C.] section 1331." *Kadic,* 70 F.3d at 238 (internal quotation marks omitted). "Thus, it is not a sufficient basis for jurisdiction to plead merely a colorable violation of the law of nations. There is no federal subject-matter jurisdiction under the [ATS] unless the complaint adequately pleads a violation of the law of nations (or treaty of the United States)." *Id.*

Plaintiffs' complaint asserts seven causes of action predicated upon the following alleged violations by the Saddam Hussein regime: (1) crimes against humanity; (2) war crimes; (3) genocide; (4) torture; (5) extrajudicial killings; (6) forced disappearances of persons; and (7) cruel, inhuman, and/or degrading treatment and/or punishment. *See* App'x 34–43. All of these claims, plaintiffs argue, are cognizable under the ATS as torts committed in violation of the law of nations or of United States treaties. *See id.* at 28–29 ¶ 158.

[10] **[11]** Violations of the law of nations, also known as customary international law, [6] are those "violations of ... international law norm [s] with [as] definite content and acceptance among civilized nations [as] the historical paradigms familiar when [the ATS] was enacted [in 1789]," *Sosa,* 542 U.S. at 732, 124 S.Ct. 2739, or, in other words, are violations of "specific and universally accepted rules that the nations of the world treat as binding *in their dealings with one another,*" *Kiobel,* 621 F.3d at 118. We do well to recall that customary international law, as Judge Friendly explained, addresses only those wrongs proscribed by "standards, rules or customs (a) affecting the relationship between states or between an individual and a foreign state, and (b) used by those states for their common good and/or in dealings *inter se.*" *IIT v. Vencap, Ltd.,* 519 F.2d at 1015; *See also Flores,* 414 F.3d at 249; n. 23, *post,* and accompanying text. By way of example, Judge Friendly rejected the notion that "the Eighth Commandment 'Thou shalt not steal' is part of the law of nations," because, "[w]hile every civilized nation doubtless has this as a part of its legal system," that is insufficient to establish it as a norm of the law of nations; rather, it must affect the relationship between states or between an individual and a foreign state, and must relate to the practice of states in their relationships *inter se. Vencap,* 519 F.2d at 1015; *See also Flores,* 414 F.3d at 249 ("[F]or example, ***181** murder of one private party by another, universally proscribed by the domestic law of all countries (subject to varying definitions), is not actionable under the AT[S] as a violation of customary international law because the nations of the world have not demonstrated that this wrong is of mutual, and not merely several, concern." (internal quotation marks omitted)).

[12] We conclude that plaintiffs have satisfied their burden of asserting some causes of action grounded in actions recognized as violations of customary international law. *See, e.g., Presbyterian Church,* 582 F.3d at 256 (acknowledging that genocide, war crimes, and crimes against humanity may be asserted as causes of action under the ATS). [7]

B. The Theory of Liability Asserted

Plaintiffs here bring claims under both an aiding and abetting and a conspiracy theory of liability. We have held that "in this Circuit, a plaintiff may plead a theory of aiding and abetting liability under the AT [S]," *Khulumani,* 504 F.3d at 260, and accordingly, plaintiffs have pleaded a theory of liability over which we have subject matter jurisdiction.

Whether there is conspiracy liability under customary international law and hence under the ATS remains an open question in this Circuit. *See Presbyterian Church,* 582 F.3d at 260 (assuming without deciding that a conspiracy theory in the form of a "joint criminal enterprise" is cognizable under the ATS). Because we ultimately dispose of these claims on jurisdictional grounds other than whether conspiracy liability is available under the ATS, *see* section II.C.5, *post,* we need not address that question here.

C. Displacing the Presumption Against Extraterritoriality

Having held that the complaint alleges violations of the law of nations, we now turn to the question of whether the presumption against the extraterritorial application of statutes bars plaintiffs' action.

1. The Supreme Court's Opinion in *Kiobel*

The Supreme Court's opinion in *Kiobel,* 133 S.Ct. 1659, significantly clarified the ***182** jurisdictional grant of the ATS with respect to extraterritoriality, and we therefore begin our jurisdictional analysis with an examination of that case.

The Supreme Court concluded in *Kiobel* that "[t]he principles underlying the presumption against extraterritoriality ... constrain courts exercising their power under the ATS." 133 S.Ct. at 1665. The Court reached this conclusion after examining the statutory text and historical setting of the ATS's passage, seeking evidence of congressional intent that it apply extraterritorially, *id.* at 1665–69, but determining that "there is no clear indication of extraterritoriality here," *id.* (internal quotation marks and alteration omitted). Accordingly, the Court held that the ATS could not form the basis for jurisdiction of U.S. courts over acts occurring entirely beyond the territory of the United States. *Id.*

At the end of its opinion, the Supreme Court held that, in the specific case before it, the ATS could not confer federal jurisdiction over plaintiff's claims because "all the relevant conduct took place outside the United States." *Id.* at 1669. Then, in language that has become the subject of interest by scholars and lower courts, the Court appeared to leave open a window for ATS actions that are based in part on extraterritorial conduct. The Court added:

> And even where the claims touch and concern the territory of the United States, they must do so with sufficient force to displace the presumption against extraterritorial application. *See Morrison,* 561 U.S. [247], 130 S.Ct. [2869,] 2883–2888. Corporations are often present in many countries, and it would reach too far to say that mere corporate presence suffices.

Id. at 1669.

An evaluation of the presumption's application to a particular case is essentially an inquiry into whether the domestic contacts are sufficient to avoid triggering the presumption at all. The presumption was not "displaced" in *Kiobel* because all of the relevant conduct alleged in that suit took place outside of U.S. territory. Yet, as the Supreme Court had previously recognized, it will often be the case that "th[e] presumption ... is not self-evidently dispositive, but its application requires further analysis." *Morrison,* 561 U.S. at 266, 130 S.Ct. 2869. As the Court noted in *Morrison,* "it is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States." *Id.*

Indeed, in the instant action, the complaint includes some "contact" between the injuries alleged and the territory of the United States. Although the depredations of the Saddam Hussein regime undeniably occurred outside of the United States, plaintiffs argue that the abuses they allegedly suffered at the hands of the Saddam Hussein regime "flow from financial transactions within the territory of the United States." Appellants' Ltr. Br. 4. In particular, plaintiffs point to the following allegations: (1) the OFP was created, administered, and its contracts approved by the United Nations in New York City, where the United Nations headquarters is located; (2) Chevron is headquartered in the United States, which means that many decisions related to the alleged violations of the OFP were "necessarily made by the top stake holders at Chevron in the United States"; (3) Chevron engaged in transactions with other U.S. companies involving the OFP oil and illicit surcharges, and its "profits reaped from the transactions were recouped in the United States"; and (4) BNP entered into a Banking Agreement with the United Nations in New York pursuant to which it maintained an escrow ***183** account in New York City through which all OFP funds moved, including the illicit surcharge payments. *Id.* at 4–5.[8]

In light of the "connections" to U.S. territory asserted in the complaint, the presumption against extraterritorial application is not "self-evidently dispositive" here, as it was in *Kiobel,* and our jurisdictional inquiry requires the "further analysis" envisaged in *Morrison.* What type of further analysis is required, and what facts are relevant to determining whether a claim sufficiently "touches and concerns" the United States so as to *displace* the presumption against extraterritorial application in the context of the ATS is a question of first impression for our Court. However, we draw considerable guidance from the teachings of the Supreme Court in several cases, in particular, from *Morrison.*[9]

2. *Morrison's* "Focus" Analysis

To determine how to undertake the extraterritoriality analysis where plaintiffs allege some "connections" to the United States, we first look to the Court's opinion in *Morrison,* in which the Court actually engaged in the required "further analysis" with respect to § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). After determining that the presumption against extraterritorial effect of statutes applied to the Exchange Act, the Court then sought to determine which "territorial event[s]" or "relationship [s]" were the "focus" of the Exchange Act. *Morrison,* 561 U.S. at 266, 130 S.Ct. 2869. The Court determined that the "focus" of the statute was on "purchases and sales of securities in the United States," rather than "the place where the deception originated." *Id.* Analyzing transactions of securities not registered on domestic exchanges, ***184** the Court again noted that "it is the foreign location of the *transaction* that establishes (or reflects the presumption of) the Act's inapplicability." *Id.* at 268, 130 S.Ct. 2869. In light of Congress's focus on domestic transactions, the Court categorically limited the territorial reach of the statute by establishing that § 10(b) applies "only [to] transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Id.* at 267, 130 S.Ct. 2869; *see id.* at 285, 130 S.Ct. 2869 (Stevens, J., concurring in the judgment) (characterizing Court's test as a "bright-line rule[ ]"); *City of Pontiac,* 752 F.3d at 180 (same).

Adopting the Supreme Court's methodology in *Morrison,* the first step of our inquiry here involves an evaluation of the "territorial event[s]" or "relationship[s]" that were the "focus" of the ATS. *Morrison,* 561 U.S. at 266, 130 S.Ct. 2869. This inquiry again begins with the Supreme Court's most comprehensive and recent examination of the ATS in *Kiobel.* There, plaintiffs were Nigerian nationals who accused Dutch, British, and Nigerian corporations of aiding and abetting violations of customary international law by Nigerian military and police forces. *Kiobel,* 133 S.Ct. at 1662. Plaintiffs claimed that the defendant multi-national corporations aided and abetted the abuses by "providing the Nigerian forces with food, transportation, and compensation, as well as by allowing the Nigerian military to use respondents' property as a staging ground for attacks." *Id.* at 1662–63. The United States ties alleged were that defendants' shares were traded on the New York Stock Exchange, and that they had a New York City office (owned by an affiliate) that "helps to explain their business to potential investors." *Id.* at 1677 (Breyer, J., concurring in the judgment).

Focusing on the fact that "all the relevant conduct took place outside the United States," the Supreme Court held that the ATS did not extend to plaintiffs' claims. *Id.* at 1669. In *Balintulo,* we explained that the phrase "relevant conduct" in *Kiobel* referred, at all times and "[i]n *all* cases," to the conduct constituting the alleged offenses under the law of nations. *Balintulo,* 727 F.3d at 189–90, 192.[10] Indeed, we undertook a careful examination of the Supreme Court's choice of language in *Kiobel,* and underscored that, on at least eleven occasions, the Court "framed" its analysis as one "focusing solely on the location of the relevant 'conduct' or 'violation.' " *Id.* at 189 (quoting *Kiobel,* 133 S.Ct. at 1665–69). Accordingly, in conducting our extraterritoriality analysis, we looked solely to the site of the alleged violations of customary international law. *Id.* at 189–90.[11]

***185** We then applied this ATS "focus" analysis—examining the conduct alleged to constitute violations of the law of nations, and the location of that conduct—to the facts of *Balintulo* itself. There, the conduct at issue was the sale, by subsidiaries of the defendant corporations, of cars and computers to the apartheid government of South Africa, which allegedly aided and abetted that regime's violations of customary international law. *Id.* at 182–83. Of particular relevance to the instant case, the *Balintulo* plaintiffs predicated their claim on an assertion that defendants "took affirmative steps in this country to circumvent the sanctions regime" against South Africa. *Id.* at 192.

We rejected the *Balintulo* plaintiffs' arguments, holding that their allegations were insufficient to displace the presumption. We reasoned that defendants' alleged domestic conduct lacked a clear link to the human rights abuses occurring in South Africa that were at the heart of plaintiffs' action. *Id.* (stating that none of plaintiffs' allegations "ties the relevant human rights violations to actions taken within the United States"). We thus concluded that the alleged violations were "based solely on conduct occurring abroad," and hence were not cognizable in U.S. courts under the teachings of the Supreme Court in *Kiobel. Id.* at 182.[12]

3. Displacing the Presumption Against Extraterritoriality Under the ATS

[13] **[14]** Drawing upon the guidance provided by the Supreme Court in *Morrison* and *Kiobel,* and by this Court in *Balintulo,* a clear principle emerges for conducting the extraterritoriality-related jurisdictional analysis required by the ATS: that the "focus" of the ATS is on conduct and on the location of that conduct. Thus, in determining whether the ATS confers on a federal court jurisdiction over a particular case, a district court must isolate the "relevant conduct" in a complaint. That conduct is the conduct of the defendant which is alleged by plaintiff to be either a direct violation of the law of nations or, as we recognized in *Presbyterian Church,* 582 F.3d at 259, conduct that constitutes aiding and abetting another's violation of the law of nations. In determining whether this conduct displaces the presumption, the district court must engage in a two-step jurisdictional analysis of this conduct.

***186** The first step is to determine whether the "relevant" conduct—conduct which constitutes a violation of the law of nations or aiding and abetting such a violation—sufficiently "touches and concerns" the territory of the United States so as to displace the presumption against extraterritoriality. *Kiobel,* 133 S.Ct. at 1669.

The second step is to make a preliminary determination that the relevant conduct—which the court has determined sufficiently "touches and concerns" the United States so as to displace the presumption—may in fact be relied upon in establishing jurisdiction. This is done through a preliminary determination that the complaint adequately states a claim that the defendant violated the law of nations or aided and abetted another's violation of the law of nations. As with all allegations contained in a complaint, the pleaded conduct must be "plausibl[e]", and allow the court "to infer more than the mere possibility of misconduct", *Iqbal,* 556 U.S. at 679, 129 S.Ct. 1937, and must—at least upon an initial examination by the district judge—appear to satisfy the standard for alleging a violation of the law of nations or aiding and abetting such a violation. This initial "glimpse" at what is ordinarily a merits determination is necessary due to the unique character of the ATS as a jurisdictional statute that derives substantive meaning from customary international law. Thus, jurisdiction can only properly be asserted over conduct that is in fact a violation of customary international law or aiding and abetting a violation. By "glimpsing" at the merits at the jurisdictional stage, the district court ensures that the conduct alleged in a complaint may properly be relied upon by the court in conducting its extraterritoriality analysis.

[15] Where a complaint alleges domestic conduct of the defendant (that, the court determines, displaces the presumption against extraterritoriality), *but* such conduct does not satisfy even a preliminary assessment of the merits, the court may not rely on that conduct for its extraterritoriality analysis. In such a circumstance, the complaint does not only fail on the merits, but must also fail as a jurisdictional matter, because where the conduct alleged does not state a claim under customary international law, it cannot form the basis of a court's jurisdiction. *See Kadic,* 70 F.3d at 238 ("Because the Alien Tort Act requires that plaintiffs plead 'a violation of the law of nations' at the jurisdictional threshold, this statute requires a more searching review of the merits to establish jurisdiction.... There is no federal subject-matter jurisdiction under the Alien Tort Act unless the complaint adequately pleads a violation of the law of nations.") (citing *Filartiga,* 630 F.2d at 887–88). This second step of the extraterritoriality analysis ensures, as Justice Breyer stated in his *Kiobel* concurring opinion, that "the statute's jurisdictional reach [will] match the statute's underlying substantive grasp." *Kiobel,* 133 S.Ct. at 1673 (Breyer, J., concurring in the judgment). [13]

Finally, we note that although a district court might deny a motion to dismiss ***187** brought pursuant to Rule 12(b)(1) if it concludes that the *complaint* passes jurisdictional muster, that does not obviate the district court's continuing obligation to ensure its own jurisdiction as the case proceeds to discovery. If subsequent materials in the record cast sufficient doubt upon the allegations in the complaint that formed the basis for the court's subject-matter jurisdiction, the court must revisit the question of its jurisdiction *sua sponte,* or upon a party's motion. *See, e.g., Grupo Dataflux v. Atlas Global Grp., L.P.,* 541 U.S. 567, 593, 124 S.Ct. 1920, 158 L.Ed.2d 866 (2004) ("[I]t is the obligation of both district court and counsel to be alert to jurisdictional requirements."); *Transatlantic Marine Claims Agency, Inc. v. Ace Shipping Corp., Div. of Ace Young Inc.,* 109 F.3d 105, 107 (2d Cir.1997) ("The failure of the parties to contest the district court's authority to hear a case does not act to confer federal jurisdiction since a challenge to subject matter jurisdiction cannot be waived and may be raised either by motion or *sua sponte* at any time.") (internal quotation marks, ellipses, and brackets omitted).

4. Relevant and Irrelevant Considerations

As we have explained above, in order to displace the presumption against extraterritoriality and establish federal subject matter jurisdiction over an ATS claim, the complaint must plead: (1) conduct of the defendant that "touch [ed] and concern[ed]" the United States with sufficient force to displace the presumption against extraterritoriality, *and* (2) that the *same conduct,* upon preliminary examination, states a claim for a violation of the law of nations or aiding and abetting another's violation of the law of nations.

In evaluating the "relevant" conduct, we are mindful of the Supreme Court's emphasis on the potential foreign policy implications of the ATS. *See Kiobel,* 133 S.Ct. at 1664–65. In all cases applying the presumption against extraterritoriality to statutes, courts must be careful to recall the relevance of this canon—namely, "to protect against unintended clashes between our laws and those of other nations which could result in international discord." *Equal Opportunity Emp't Comm'n v. Arabian Am. Oil Co. ("ARAMCO "),* 499 U.S. 244, 248, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991); *See also Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE,* 763 F.3d 198, 216 (2d Cir.2014) (holding a claim brought under § 10(b) of the Securities Exchange Act barred as extraterritorial because "the application of § 10(b) to the defendants would so obviously implicate the incompatibility of U.S. and foreign laws that Congress could not have intended it *sub silentio* "). This core purpose of the presumption is even more pronounced here: "[T]he danger of unwarranted judicial interference in the conduct of foreign policy is magnified in the context of the ATS, because the question is not what Congress has done but instead what courts may do." *Kiobel,* 133 S.Ct. at 1664. Describing the dangers inherent when courts impinge on the role of the executive and legislative branches in managing foreign policy, the Court explained, "[t]hese concerns, which are implicated in any case arising under the ATS, are all the more pressing when the question is whether a cause of action under the ATS reaches conduct within the territory of another sovereign." *Id.* at 1665. Thus, as instructed by the Supreme Court, the lower federal courts must proceed with caution when determining whether a particular case alleges conduct that is sufficiently "domestic," such that the presumption is "displaced" (*i.e.,* does not apply).

***188** **[16]** Furthermore, in identifying the conduct which must form the basis of the violation *and* the jurisdictional analysis under the ATS, precedents make clear that neither the U.S. citizenship of defendants, nor their presence in the United States, is of relevance for jurisdictional purposes. First, in *Kiobel* the Court explicitly stated that "mere corporate presence" in the United States would be insufficient to displace the presumption against extraterritoriality. 133 S.Ct. at 1669. And in *Balintulo,* we described a defendant's citizenship as "an irrelevant factual distinction," and expressly rejected plaintiff's contention that "corporate citizenship [of a defendant] in the United States is enough" to displace the presumption. 727 F.3d at 189–90. And indeed, in another case in which the Supreme Court assessed the extraterritorial effect of a statute, the fact that the defendant corporations were American did not render defendant's overseas activities sufficiently domestic. *See ARAMCO,* 499 U.S. at 247, 111 S.Ct. 1227 (holding that Title VII of the Civil Rights Act of 1964 did not apply extraterritorially to a Delaware corporation's treatment of its U.S. citizen employee in Saudi Arabia).

Recently, the Eleventh Circuit reached the same conclusion. In *Cardona v. Chiquita Brands Int'l, Inc.,* the Court of Appeals rejected plaintiffs' "attempt to anchor ATS jurisdiction in the nature of the defendants as United States corporations." 760 F.3d at 1189. In discarding this argument, the Court of Appeals quoted the Supreme Court's directive in *Kiobel* that "mere corporate presence" does not suffice to displace the presumption, and it identified no significant distinction between corporate presence and citizenship for purposes of analyzing domestic connections. *Id.* (quoting *Kiobel,* 133 S.Ct. at 1669).

Other courts have considered a defendant's U.S. citizenship as one germane factor among numerous factors that, when viewed together, sufficiently "touch and concern" the United States so as to confer jurisdiction on the federal courts over a case. In *Al Shimari v. CACI Premier Technology Inc.,* 758 F.3d 516 (4th Cir.2014), the Fourth Circuit held that ATS claims related to alleged torture of plaintiffs that took place at the Abu Ghraib prison in Iraq, at the hands of interrogators employed by the defendant corporation, sufficiently "touched and concerned" the United States. *Id.* at 530. The Court of Appeals reached this conclusion based upon the combination of numerous domestic contacts, including: defendant's status as a U.S. corporation; the U.S. citizenship of defendant's employees, "upon whose conduct the ATS claims are based"; defendant's status as a contractor of the U.S. government; and allegations of domestic conduct by defendants in approving, encouraging, and covering up the alleged torture.[14] *Id.* at 530–31.

***189** We disagree with the contention that a defendant's U.S. citizenship has any relevance to the jurisdictional analysis. The Supreme Court made clear in *Kiobel* that the full "focus" of the ATS was on conduct. *See Balintulo,* 727 F.3d at 190–91 & n. 24. Whether a complaint passes jurisdictional muster accordingly depends upon alleged conduct by *anyone*—U.S. citizen or not—that took place in the United States and aided and abetted a violation of the law of nations. A complaint cannot be "saved" for jurisdictional purposes simply because a U.S. citizen happened to commit the alleged violation; similarly, our jurisdiction over actions taken within the United States is not less clear where they are actions of a foreign national rather than a U.S. citizen.[15] *Cf. Absolute Activist Value Master Fund Ltd. v. Ficeto,* 677 F.3d 60, 69 (2d Cir.2012) (noting, in a case applying the Supreme Court's *Morrison* opinion, that in identifying domestic as opposed to extraterritorial transactions, "[a] purchaser's citizenship or residency does not affect where a transaction occurs; a foreign resident can make a purchase within the United States, and a United States resident can make a purchase outside the United States") (internal quotation marks omitted).

5. Application

We now turn to the complaint at hand, looking to see whether the complaint has pleaded: (1) conduct by defendants that "touch[ed] and concern [ed]" the United States with sufficient force to displace the presumption against extraterritoriality, *and* (2) that the *same conduct,* upon preliminary examination, states a claim for a violation of the law of nations or aiding and abetting another's violation of the law of nations.

The conduct alleged in the complaint that plaintiffs contend is sufficient to displace the presumption against extraterritoriality is that: (1) the OFP was created, administered, and its contracts were approved by the United Nations in New York City, where the United Nations headquarters is located; (2) Chevron is headquartered in the United States, which means that many decisions related to the alleged violations of the OFP were "necessarily made by the top stake holders at Chevron in the United States"; (3) Chevron engaged in transactions with other ***190** U.S. companies involving the OFP oil and illicit surcharges, and its "profits reaped from the transactions were recouped in the United States"; and (4) BNP entered into a Banking Agreement with the United Nations in New York pursuant to which it maintained an escrow account in New York City through which all OFP funds moved, including the illicit surcharge payments.

First, the fact that the United Nations is located in New York, and that the OFP's inception and administration occurred in New York, is irrelevant. Such allegations, by themselves, are not facts related to defendants at all, let alone alleged conduct taken by defendants to aid and abet violations of the law of nations.

Second, where Chevron is headquartered is also immaterial, because, as just discussed, the relevant inquiry is on conduct constituting a violation of customary international law or of aiding and abetting such violations, not on where defendants are present. A defendant's nationality or citizenship is pertinent only insofar as it relates to its alleged U.S. conduct.

Third, our jurisdictional analysis need not take into account allegations that, on their face, do not satisfy basic pleading requirements. Allegations must be more than "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements." *Iqbal,* 556 U.S. at 678, 129 S.Ct. 1937. Plaintiffs' assertion that, because Chevron was headquartered in the United States, "much of the decisionmaking to participate in the [OFP] scheme" was necessarily made in the United States, is just such a conclusory assumption. Appellants' Ltr. Br. 4. [16]

[17] Yet plaintiffs do make additional allegations of Chevron and BNP's U.S.-based attempts to skirt the sanctions regime, the combination of which appear to "touch and concern" the United States with sufficient force to displace the presumption. For example, plaintiffs allege that Iraqi oil under contract with Russian companies "was in fact purchased and financed ... in the United States" by Chevron, Compl. ¶ 57, and that "Chevron financed the sale of two million barrels of oil to Bulf Oil through Midway Oil of Reston, Virginia" for which Chevron "facilitated" "a surcharge payment of nearly half a million dollars be paid to the [Saddam Hussein] regime," *id.* ¶¶ 73–75. They further allege, as a general matter, that "profits rendered from the transactions w [ere] recouped in the United States." *Id.* ¶ 17.

[18] Regarding BNP, plaintiffs allege that BNP "maintained the escrow account in New York City" through which all payments were transmitted pursuant to the OFP. Appellants' Ltr. Br. 4. They further allege that "BNP allowed payments through the New York escrow account that included kickbacks to the [Saddam Hussein] Regime," that "BNP's financing arrangements in New York allowed the oil purchasers to conceal the true nature of the oil purchase." *Id.* at 5. Allegedly, "BNP enabled the oil purchasers and humanitarian goods suppliers to include funds [diverted to the Saddam Hussein regime] which were not captured in the escrow account," and the illicit "oil surcharge scheme relied on the financing arrangements made by BNP Paribas in ***191** three-fourths of the transactions." Compl. ¶¶ 113–14,121.

This particular combination of conduct in the United States—on the part of Chevron, multiple domestic purchases and financing transactions; on the part of BNP, numerous New York-based payments and "financing arrangements" conducted exclusively through a New York bank account—is both specific and domestic. These allegations assert non-conclusory conduct that appears to "touch[ ] and concern[ ]" the United States with sufficient force to displace the presumption against extraterritoriality and establish our jurisdiction under the ATS,[17] if such conduct also meets the second prong of our extraterritoriality analysis—*i.e.,* if it satisfies a preliminary determination that such conduct aided and abetted a violation of the law of nations. To do this, we provide a brief overview of the elements necessary to state a claim for aiding and abetting a violation of the law of nations under the ATS.

Our decision in *Presbyterian Church* resolved earlier uncertainty about the elements of a claim of aiding and abetting liability under the ATS. There, plaintiffs were Sudanese citizens who brought suit under the ATS against a Canadian oil company, alleging that security arrangements for the company carried out by the Sudanese government led to persecution of citizens living near oil concession areas. 582 F.3d at 249–52. Evaluating whether it was sufficient to state a claim that the defendant company *knew* of the alleged abuses, we held that "the *mens rea* standard for aiding and abetting liability in ATS actions is *purpose* rather than knowledge alone." *Id.* at 259 (emphasis supplied).[18] We noted the lack of a sufficient ***192** international consensus "for imposing liability on individuals who *knowingly* (but not purposefully) aid and abet a violation of international law." *Id.* Assuming, without deciding, that conspiracy liability for completed offenses was a valid theory in an ATS action,[19] we also concluded that any such claims would require the same *mens rea* element as claims for aiding and abetting. *Id.* at 260.

In establishing this standard as the law of the Circuit, the unanimous *Presbyterian Church* panel relied substantially and expressly on Judge Katzmann's concurring opinion in an earlier case, *Khulumani,* 504 F.3d at 264. There, Judge Katzmann conducted a lengthy analysis of relevant sources of international law and concluded that "a defendant may be held liable under international law for aiding and abetting the violation of that law by another when the defendant (1) provides practical assistance to the principal which has a substantial effect on the perpetration of the crime, and (2) does so with the *purpose* of facilitating the commission of that crime." *Id.* at 277 (emphasis supplied).[20] Accordingly, the defendant's "complicity" in the government's abuses in *Presbyterian Church,* without more, was insufficient to establish a claim of aiding and abetting or conspiracy under the ATS. 582 F.3d at 263.

[19] Upon a preliminary analysis of the conduct alleged in the complaint—conducted merely to confirm that this conduct, upon which we would otherwise rely in holding that the presumption against extraterritoriality is displaced, may in fact form the basis of our jurisdiction—we conclude that plaintiffs clearly do not meet the *mens rea* requirement established in *Presbyterian Church.*[21] In their supplemental brief, plaintiffs summarize their *mens rea* allegations as follows: "the complaint alleges that Chevron and BNP acted both with the express *purpose* of violating the rules governing the Oil for Food Programme" and "*knew* full well that doing so promoted serious human rights abuses in Iraq." Appellants' Ltr. Br. 6 (emphasis added).[22] In other words, plaintiffs assert ***193** that defendants acted *purposefully* in violating the OFP, but merely *knowingly* in aiding and abetting the underlying violations of the law of nations.[23]

[20] Plaintiffs thus miss the mark and misconstrue our clear holding in *Presbyterian Church.* The relevant inquiry at all times is whether plaintiffs' complaint "supports an inference that [defendants] acted with the 'purpose' to advance the Government's human rights abuses," *Presbyterian Church,* 582 F.3d at 260, *not* whether defendants merely *knew* that those abuses were occurring and that defendants' business was enabling such acts. Plaintiffs' allegations that defendants *intentionally* flouted the sanctions regime for profit, or that they *knew* their actions were in violation of United Nations Security Council resolutions, or "international law," or U.S. policy are irrelevant to the *mens rea* inquiry; rather, our analysis necessarily focuses on allegations that defendants *intended* to aid and abet violations of *customary international law* carried out by the Saddam Hussein regime—a contention that is unsupported by the facts alleged in the complaint.[24]

***194** Where the complaint appears to allege something akin to *purpose,* it does so in conclusory terms and fails to establish even a baseline degree of plausibility of plaintiffs' claims. For example, the complaint alleges in its introduction that "[d]efendants conspired with the Saddam Hussein regime to maintain control and power over Iraq in order to secure mutual financial benefits through the egregious affronts on the human rights of the [p]laintiffs." Compl. Introduction.

Plaintiffs never elaborate upon this assertion in any way that establishes the plausibility of a large international corporation intending—and taking deliberate steps with the purpose of assisting—the Saddam Hussein regime's torture and abuse of Iraqi persons. *See Kiobel,* 621 F.3d at 192 (Leval, J., concurring in the judgment) ("[T]he complaint pleads also in conclusory form that the Nigerian military's campaign of violence against the [victim—plaintiffs] was 'instigated, planned, facilitated, conspired and cooperated in' by [defendant corporation]. Such pleadings are merely a conclusory accusation of violation of a legal standard and do not withstand the test of *Twombly* and *Iqbal.*"). Other points at which the complaint seems to allege purposeful action are similarly conclusory, and also fail to directly link the allegedly intentional conduct with the human rights abuses at the heart of the complaint.[25] They thus fall short of the pleading standards required by *Iqbal* and *Twombly.*

In the instant case, the District Court correctly recognized this pleading deficiency, albeit in its discussion of the TVPA. It concluded that "nothing in the complaint suggests (even in a conclusory fashion) that the defendants acted with the purpose of facilitating human rights abuses," and went even further, concluding that the "claims as presently pleaded even fail to meet the less stringent common law standard for aiding-and-abetting liability, which requires that the defendants had 'actual knowledge' that their actions would contribute to the commission of human rights abuses." *Mastafa v. Chevron Corp.,* 759 F.Supp.2d 297, 300 (S.D.N.Y.2010).

Because the complaint fails plausibly to plead that defendants' conduct related to aiding and abetting the alleged violations of customary international law was intentional, that conduct cannot form the basis for our jurisdiction.

Accordingly, we conclude that the District Court did not have subject-matter jurisdiction over this case.

CONCLUSION

To summarize, we hold that:

(1) The defendants in this action are corporations, and thus, pursuant to the Supreme Court's decision in *Mohamad* ***195** *v. Palestinian Authority,* [––– U.S. ––––] 132 S.Ct. 1702 [182 L.Ed.2d 720] (2012), they indisputably are not subject to liability under the TVPA.

(2) In adjudicating claims brought under the ATS, a "jurisdictional statute," courts should begin their analysis with the question of their jurisdiction over such claims before proceeding to a determination on the merits.

(3) There are several jurisdictional predicates that must be satisfied before a court can be assured of its jurisdiction over an ATS claim, and the order and manner in which a district court undertakes these inquiries is a matter of discretion based upon the particular circumstances presented.

(4) Plaintiffs here satisfied their burden of asserting causes of action grounded in actions recognized as violations of customary international law.

(5) Plaintiffs alleged a theory of liability—aiding and abetting—that is cognizable under customary international law.

(6) In determining whether a claim under the ATS sufficiently "touches and concerns" the United States with sufficient force to displace the presumption against extraterritorial application, courts must consider the following principles:

a. Under the Supreme Court's decisions in *Morrison* and *Kiobel,* and our Court's opinion in *Balintulo,* the "focus" of the ATS—and, thus, the focus of the jurisdictional inquiry—is the conduct alleged to violate the law of nations (or alleged to aid and abet the violation of the law of nations), and where that conduct occurred.

b. To establish our jurisdiction under the ATS, the complaint must plead: (1) conduct of the defendant that "touch[ed] and concern[ed]" the United States with sufficient force to displace the presumption against extraterritoriality, *and* (2) that the *same conduct,* upon preliminary examination, states a claim for a violation of the law of nations or aiding and abetting another's violation of the law of nations.

c. In identifying the "relevant conduct" for jurisdictional purposes, Supreme Court and Second Circuit precedent make clear that neither the U.S. citizenship of defendants, nor their mere presence in the United States, is relevant to a court's determination of its jurisdiction.

d. Here, plaintiffs have alleged specific, domestic conduct in the complaint—namely, Chevron's oil purchases, financing of oil purchases, and delivery of oil to another U.S. company, all within the United States; and BNP's use of a New York escrow account and New York-based "financing arrangements" to systematically enable illicit payments to the Saddam Hussein regime that allegedly facilitated that regime's violations of the law of nations, namely war crimes, genocide, and other crimes against humanity. This U.S.-based conduct "touches and concerns" the United States to satisfy the first prong of our extraterritoriality analysis.

e. The complaint fails plausibly to plead that defendants' conduct related to aiding and abetting the alleged violations of customary international ***196** law was intentional, and accordingly, the conduct cannot state a claim for aiding and abetting liability under the ATS and thus cannot form the basis for our jurisdiction.

For the reasons stated above, the judgment of the District Court is AFFIRMED.

All Citations

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Footnotes

[1] The ATS is unusual in that it confers upon "aliens" a cause of action in U.S. courts. The fact that two of the plaintiffs are now U.S. citizens raises the question whether they have statutory standing to assert a cause of action under the ATS. Because neither party has addressed this question, we assume without deciding for purposes of this opinion that these particular U.S. citizen plaintiffs, who were "aliens" at the time of the alleged violations at issue, may bring an action under the ATS.

[2] *See, e.g., Kiobel,* 621 F.3d at 116 (describing ATS jurisdiction over "violations of the law of nations (also called 'customary international law')"); *Vietnam Ass'n for Victims of Agent Orange v. Dow Chem. Co.,* 517 F.3d 104, 116 (2d Cir.2008) (noting that "[i]n the broader context" beyond ATS litigation, "the law of nations has become synonymous with the term 'customary international law' "); *Flores v. Southern Peru Copper Corp.,* 414 F.3d 233, 237 n. 2 (2d Cir.2003) ("In the context of the [ATS], we have consistently used the term 'customary international law' as a synonym for the term the 'law of nations.' "); *Filartiga v. Pena–Irala,* 630 F.2d 876, 884 (2d Cir.1980) (considering sources of "customary international law" in determining that "official torture is now prohibited by the law of nations"); *see also Hartford Fire Ins. Co. v. California,* 509 U.S. 764, 815, 113 S.Ct. 2891, 125 L.Ed.2d 612 (1993) (Scalia, J., dissenting in part) (using the terms interchangeably when noting that " 'the law of nations' or customary international law, includes limitations on a nation's exercise of its jurisdiction to prescribe").

[3] Plaintiffs did not challenge the District Court's dismissal of claims brought pursuant to New York law in their initial appellate briefs, nor in their supplemental letter brief. Accordingly, the dismissal of those claims is not addressed here or disturbed in any way by this decision.

[4] *See generally Freedom in the World Country Ratings (2014),* Freedom House, *available at* http://www.freedomhouse. org/sites/default/files/Country% 20Status% 20% 26% 20Ratings% 20Overview#% 201973-2014.pdf (asserting that in 2014, only 45% of countries in the world were characterized as "free," while 30% were "partly free" and 24% were "not free"). Those living in countries characterized as "not free" generally have very restricted or no civil liberties, including very limited or no freedom of expression or association, and very restricted or no political rights, and thus likely suffer numerous depredations, not all of which are actionable under customary international law (or "the law of nations"). *See* Freedom House, Ratings and

Status Characteristics, http:// www.freedomhouse.org/report/freedom-world2014/methodology#.U_4Oq8VdWR (last visited Aug. 27, 2014).

[5] We note that the District Court dismissed all of plaintiffs' ATS claims from the bench "because of the decision of the Second Circuit in *Kiobel,*" App'x 58, referring to our *Kiobel* opinion, in which we held that "[b]ecause corporate liability is not recognized as a specific, universal, and obligatory norm ... it is not a rule of customary international law that we may apply under the ATS." 621 F.3d at 145 (internal quotation marks and citation omitted). Although the holding of our *Kiobel* opinion has not been modified or disturbed, *see Chowdhury v. Worldtel Bangladesh Holding, Ltd.,* 746 F.3d 42, 49 n. 6 (2d Cir.2014); *Balintulo v. Daimler AG,* 727 F.3d 174, 191 n. 26 (2d Cir.2013), plaintiffs argue in their supplemental brief that we should reevaluate the holding of our *Kiobel* opinion. *See* Appellants' Ltr. Br. 2–3. As it happens, we have no need to address that argument because we dispose of plaintiffs' claims on other jurisdictional grounds.

[6] *see* note 2, *ante.*

[7] Plaintiffs also allege causes of action for torture; extrajudicial killing; forced disappearances of persons; and cruel, inhuman, and/or degrading treatment and/or punishment. Were these the only causes of action alleged, we would remand to the District Court for a determination in the first instance of whether they constitute violations of customary international law. However, because plaintiffs have pleaded three causes of action that unquestionably allege violations of customary international law—war crimes, genocide, and other crimes against humanity—they have satisfied this jurisdictional predicate. As we ultimately conclude that the claim is barred as a jurisdictional matter by the presumption against extraterritoriality, *see* section II.C.5, *post,* we need not remand this question to the District Court.

Accordingly, we intimate no view on whether these in fact are violations of the law of nations, nor on other corollary questions that would need be answered in order to make such a determination, including whether the TVPA, enacted in 1991, now provides the sole means by which plaintiffs can bring claims based upon torture and extrajudicial killing. *See Enahoro v. Abubakar,* 408 F.3d 877, 884–85 (7th Cir.2005) (concluding that in enacting the TVPA, Congress established it as the sole means through which a plaintiff could allege claims for extrajudicial killing and torture, because "[i]f it did not, it would be meaningless. No one would plead a cause of action under the TVPA and subject himself to its requirements if he could simply plead under" the ATS); *cf. Filartiga,* 630 F.2d at 880 (holding, well before the TVPA was passed, that "an act of torture committed by a state official against one held in detention violates established norms of the international law of human rights, and hence the law of nations").

[8] Whether conduct occurring within the United Nations Headquarters in New York City constitutes domestic or extraterritorial conduct for purposes of our jurisdictional inquiry is a novel question. Pursuant to the relevant agreement between the United States and United Nations, the United Nations "headquarters district," including the Headquarters building, has been afforded a unique status. *See* Agreement Between the United Nations and the United States of America Regarding the Headquarters of the United Nations, *reprinted at* 22 U.S.C. § 287 historical note ("U.N. Headquarters Agreement"). Nonetheless, conduct occurring within the headquarters district is subject to the same jurisdictional analysis as if such conduct occurred anywhere else in New York City. We so conclude based upon the agreement's provision that "the federal, state and local courts of the United States shall have jurisdiction over acts done and transactions taking place in the headquarters district as provided in applicable federal, state and local laws." U.N. Headquarters Agreement § 7(c). Therefore, conduct that occurred within the United Nations Headquarters will be treated as domestic conduct for purposes of the jurisdictional analysis under the ATS.

[9] At the outset of our analysis, we acknowledge (as did the Supreme Court in *Kiobel,* 133 S.Ct. at 1664) that the presumption against the extraterritoriality of statutes has typically been applied to substantive statutes that regulate conduct, rather than purely jurisdictional statutes, such as the ATS. *See, e.g., Morrison,* 561 U.S. at 273, 130 S.Ct. 2869 (holding that the presumption against extraterritoriality applied to section 10(b) of the Securities Exchange Act, precluding claims for misconduct in connection with securities traded on foreign exchanges); *Sale v. Haitian Ctrs. Council, Inc.,* 509 U.S. 155, 159, 113 S.Ct. 2549, 125 L.Ed.2d 128 (1993) (holding that section 243(h) of the Immigration and Nationality Act of 1952 did not apply extraterritorially); *Equal Opportunity Emp't Comm'n v. Arabian Am. Oil Co.,* 499 U.S. 244, 259, 111 S.Ct. 1227, 113 L.Ed.2d 274 (1991) (holding that Title VII of the Civil Rights Act of 1964 did not apply extraterritorially). While mindful of the distinction between substantive and jurisdictional statutes, we think the Court's analysis in the above cases, applying the presumption against extraterritoriality to substantive statutes, is instructive and relevant to the question presented here.

[10] We have recently had another occasion to apply the Supreme Court's *Kiobel* holding in *Chowdhury,* 746 F.3d 42, where we determined that, because all of the conduct set forth in plaintiff's complaint occurred in Bangladesh, his claims brought under the ATS were not cognizable. *Id.* at 49–50.

11 After determining that the ATS does not apply extraterritorially, the Supreme Court in *Kiobel* had no need to decide what allegations would be sufficient to displace the presumption, because the *Kiobel* plaintiffs did not allege any conduct that took place in the United States.

However, in his concurring opinion in *Kiobel,* Justice Alito did explicitly apply the *Morrison* "focus" analysis to the ATS. In doing so, he noted that, pursuant to the Supreme Court's opinion in *Sosa,* 542 U.S. 692, 124 S.Ct. 2739, "when the ATS was enacted, congressional concern was focus[ed] on the three principal offenses against the law of nations that had been identified by Blackstone: violation of safe conducts, infringement of the rights of ambassadors, and piracy." 133 S.Ct. at 1670 (Alito, J., concurring) (internal quotation marks and citation omitted). He thus concluded that "a putative ATS cause of action will fall within the scope of the presumption against extraterritoriality—and will therefore be barred—unless the domestic conduct is sufficient to violate an international law norm that satisfies *Sosa*'s requirements of definiteness and acceptance among civilized nations." *Id.*

We agree that a defendant's domestic conduct must be the focal point of our inquiry. This reflects the perspective of the majority opinion of the Chief Justice in *Kiobel* and its repeated emphasis on "the location of the relevant 'conduct' or 'violation.' " *Balintulo,* 727 F.3d at 189. Accordingly, the site of the alleged violation should be the central inquiry for lower courts asked to apply the *Kiobel* presumption to facts allegedly sufficient to overcome it.

12 In *Balintulo,* we denied defendants' request that we issue a writ of mandamus ordering the District Court to dismiss all claims against them. We denied that request because we held that, in light of the *Kiobel* presumption, recognized by the Supreme Court while the *Balintulo* appeal was pending, "the defendants w[ould] be able to obtain their desired relief (dismissal of all claims) in the District Court through a motion for judgment on the pleadings, without resort to a writ of mandamus." *Balintulo,* 727 F.3d at 182. As described above, our decision to deny the extraordinary writ of mandamus was based on the holding that the plaintiffs' alleged "violations of customary international law based solely on conduct occurring abroad" were not cognizable in U.S. courts under the ATS. *Id.*

13 We observe that Justice Breyer's opinion explicitly regarded the extraterritoriality analysis required by the majority opinion in *Kiobel* to be jurisdictional in nature, a conclusion that triggered no protest from the majority. *Id.* at 1673 (Breyer, J., concurring in the judgment). This approach is consistent with our understanding of the ATS as a "strictly jurisdictional" creature. *Sosa,* 542 U.S. at 713, 124 S.Ct. 2739. Accordingly, the general presumption that a limitation on a statute's coverage will be treated as nonjurisdictional unless Congress clearly states otherwise, *see Arbaugh v. Y & H Corp.,* 546 U.S. 500, 515–16, 126 S.Ct. 1235, 163 L.Ed.2d 1097 (2006), is not applicable in the context of the ATS.

14 Some district courts have similarly considered a defendant's U.S. citizenship as one pertinent factor among others, including the defendant's conduct. In *Sexual Minorities Uganda v. Lively,* 960 F.Supp.2d 304 (D.Mass.2013), the court held that the presumption against extraterritoriality was displaced by distinguishing the case from *Kiobel* in two ways: (1) because "[d]efendant is an American citizen residing within ... Massachusetts" and (2) because "the tortious acts committed by [d]efendant took place to a substantial degree within the United States," including "planning and managing a campaign of repression in Uganda from the United States." *Id.* at 321–22. The court likened defendant's U.S.-based conduct to "a terrorist designing and manufacturing a bomb in this country," which he then detonates overseas. *Id.* at 322. As explained above, we would look only to defendant's conduct in the United States, but not to his citizenship in determining our jurisdiction. *See also Du Daobin v. Cisco Sys., Inc.,* 2 F.Supp.3d 717, 728 (D.Md.2014) (assuming, without deciding, that the presumption against extraterritoriality was displaced in an ATS case because: (1) defendant was an American, rather than foreign, corporation, and (2) "developmental actions relevant to the [alleged law of nations violation] took place predominantly, if not entirely, within the United States," and "defendant ... has taken certain actions within the United States with respect to products that might be primarily used for violations of the laws of nations").

15 In conducting the "touch and concern" jurisdictional analysis, one district court, faced with an ATS claim against Osama bin Laden and al-Qaeda stemming from the bombing of the U.S. Embassy in Nairobi, looked to both defendants' U.S.—based conduct, as well as the intended effect of the conduct in the United States. *See Mwani v. Laden,* 947 F.Supp.2d 1, 5 (D.D.C.2013). There, the court held that the claims at issue sufficiently "touched and concerned" the United States so as to confer the court with ATS jurisdiction, because "[s]urely, if any circumstances were to fit the Court's framework of 'touching and concerning the United States with sufficient force,' it would be a terrorist attack that 1) was plotted in part within the United States, and 2) was directed at a United States Embassy and its employees," and certified that disposition for immediate review by the D.C. Circuit. *Id.* Because, in the case before us, plaintiffs do not assert that the Saddam Hussein regime's alleged violations of the law of nations were directed at, or felt in, the United States, we leave for another day the question of whether and how that fact might affect the jurisdictional analysis.

16 We also note that the only place plaintiffs allege that "decisionmaking to participate in the scheme" took place in the United States was in their supplemental letter brief, rather than in their complaint. Appellants' Ltr. Br. 4. Nevertheless, we include

it in our analysis as a corollary of the clearly-pleaded facts of Chevron's United States activities related to the alleged OFP violations. *See* App'x 12.

17 In concluding that these allegations of domestic conduct "touch [ ] and concern[ ]" the United States with sufficient force to displace the presumption against extraterritoriality, we note the analytical similarity between the allegations in this complaint, and those in another case in which the district court conducted the ATS extraterritoriality analysis according to the framework we have articulated here. In *Krishanti v. Rajaratnam*, the district court found that it had subject matter jurisdiction over the ATS claims because, although the alleged effects of defendant's violations of the law of nations were felt exclusively in Sri Lanka, the claim was based entirely on "alleged actions that occurred within the United States" including defendant's hosting of meetings and fundraisers for a foreign terrorist organization in New Jersey, donating money to a U.S.-based group which was purposefully funneled to the terrorist organization, and creating corporations in the United States to further facilitate donations to the terrorist organization. No. 2.09 Civ. 05395, 2014 WL 1669873, at *10 (D.N.J. Apr. 28, 2014).

18 It is not disputed that this *mens rea* standard—requiring defendants to act with the purpose of aiding and abetting violations of the law of nations—has become the law of the Circuit. *See, e.g., In re Terrorist Attacks on September 11, 2001,* 718 F.Supp.2d 456, 493–94 (S.D.N.Y.2010), *aff'd on other grounds,* 714 F.3d 118, 125 (2d Cir.2013); *Ahmad v. Christian Friends of Israeli Cmtys.,* No. 13 Civ. 3376, 2014 WL 1796322, at *5 (S.D.N.Y. May 5, 2014). In his opinion concurring in the judgment in this Circuit's *Kiobel* opinion, Judge Leval would have rested the decision to dismiss the complaint in that case on a conclusion that the complaint did "not contain allegations supporting a reasonable inference that Appellants acted with a purpose of bringing about the alleged abuses." *Kiobel,* 621 F.3d at 188 (Leval, J., concurring in the judgment); *See also id.* at 158 ("In this circuit, supplying financing or military equipment to a local government will not support the imposition of aiding and abetting liability on the corporation for that government's abuses unless the corporation acted *with a purpose* to promote or advance those violations.... A true question of tort liability for corporate aiding and abetting in government atrocities would be raised where such a defendant *purposely* procures the commission of genocide by local government forces."); *Kiobel v. Royal Dutch Petroleum Co.,* 642 F.3d 379, 380 (2d Cir.2011) (Katzmann, J., dissenting in the denial of reh'g en banc) ("In *Presbyterian Church* ... the unanimous panel—Chief Judge Jacobs, Judge Leval, and Judge Cabranes—adopted [Judge Katzmann's *Khulumani*] analysis as the 'law of this Circuit,' and held that we must look 'to international law to find the standard for accessorial liability' under the AT[S].") (quoting *Presbyterian Church,* 582 F.3d at 258–59)).

19 *see* section II.B, *ante.*

20 Judge Katzmann reminded those relying on his reasoning that "[i]nternational law, like our domestic law, can change." *Khulumani,* 504 F.3d at 277. On that score, he noted in passing that "there is some support ... for a definition of aiding and abetting that would lead to liability where an individual provides substantial assistance with the *knowledge* that the acts performed by the aider and abettor assist the commission of the specific crime of the principal." *Id.* at 278 (emphasis supplied) (internal quotation marks omitted). However, this arguable opening offers no assistance to plaintiffs in this action, because they do not suggest, much less show, that international law norms have shifted to recognize a different or broader rule of aiding and abetting liability since the *Khulumani* and *Presbyterian Church* decisions.

21 This analysis applies with equal force to plaintiffs' claim predicated upon a theory of conspiracy. Although we do not decide whether conspiracy is in fact available under customary international law, we have already held that "under a theory of relief based on a joint criminal enterprise, plaintiffs' conspiracy claims would require the same proof of *mens rea* as their claims for aiding and abetting." *Presbyterian Church,* 582 F.3d at 260.

22 *see, e.g.,* Compl. ¶ 14 ("The Defendants ... supported, assisted, bolstered, and aided the Saddam Hussein regime ... with full knowledge of the [abuses]."); *id.* ¶ 46 ("The payments that Chevron knowingly made to the Saddam Regime were a substantial factor in causing the [abuses]."); *Id.* ¶ 76 ("Chevron knew the surcharge was illegal."); *Id.* ¶ 90 ("Chevron knew that the surcharge payments were substantially aiding the Saddam Regime in its campaign of torture and abuse of the Plaintiffs and the members of their class."); *Id.* ¶ 143 ("BNP had first hand knowledge of the true nature of the financial transactions to purchase oil and failed to disclose the information or prevent payments from being made directly to the Saddam Regime.").

23 Plaintiffs also argue, without further explanation or support in the case law, that the instant case is distinct from *Presbyterian Church* because "abuses of the Oil for Food Programme ... are *themselves* violations of international law." Appellants' Ltr. Br. 7. This assertion reflects a misunderstanding of basic principles of our ATS jurisprudence, and an explanatory note is thus in order lest others seek to advance a similarly misplaced argument.

As we explained earlier, *see* Part II.A, *ante,* The ATS does not confer the federal courts with jurisdiction over any and all arguable violations of international law. Rather, ATS jurisdiction is much narrower, recognizing a "modest number" of claims, each of which must "rest on a norm of international character accepted by the civilized world and defined with a specificity comparable to the features of the 18th-century paradigms we have recognized." *Sosa,* 542 U.S. at 724–25, 124 S.Ct. 2739. As we have previously explained, it applies only to violations of "customary international law," a body of law which "reflect[s] the practices and customs of States in the international arena that are applied in a consistent fashion and that are generally recognized by what used to be called 'civilized states.' " *United States v. Yousef,* 327 F.3d 56, 92 (2d Cir.2003). As Judge Friendly explained, even if a legal norm appears in the domestic code of every "civilized nation"—robbery, murder, and thuggery of all kinds are examples—it only rises to the level of customary international law if it "(a) affect[s] the relationship between states or between an individual and a foreign state, and (b) [is] used by those states for their common good and/or in dealings *inter se." Vencap,* 519 F.2d at 1015. Customary international law "does not stem from any single, definitive, readily-identifiable source," *Flores,* 414 F.3d at 248, and thus, contrary to plaintiffs' assertion above, it is incorrect to simply conflate any violation of "international law" with a violation of *customary* international law. *See also* section II.A, *ante.*

[24] The fact pattern presented here is similar in some relevant respects to that encountered by the Fourth Circuit in *Aziz v. Alcolac, Inc.,* 658 F.3d 388 (4th Cir.2011), and the Court of Appeals' reasoning there is instructive. There, the defendant was a British company that sold a certain chemical—which could be used to make mustard gas—to another company that was a shell corporation facilitating acquisition of the chemical for the Iraqi government, in violation of U.S. law. *Id.* at 391. Plaintiffs were individuals of Kurdish descent who either were harmed by Iraqi government chemical attacks, or were relatives of those killed by such attacks. *Id.* The Fourth Circuit first relied upon our opinion in *Presbyterian Church,* and Judge Katzmann's reasoning in his concurring opinion in *Khulumani,* to hold that claims of aiding and abetting are cognizable under the ATS, *see id.* at 396, and then held that such claims must be based on an allegation that defendants had the *purpose* of facilitating the violations, *id.* at 401.

Applying those conclusions to the circumstances there presented, the Fourth Circuit held that plaintiffs did not sufficiently plead intentional conduct by claiming, without further explanation, that defendant had "placed [the chemical at issue] into the stream of international commerce with the purpose of facilitating the use of said chemicals in the manufacture of chemical weapons to be used, among other things, against the Kurdish population in northern Iraq." *Id.* at 401. Here, the complaint's allegations relating to intentional conduct are similarly lacking, unsubstantiated, and conclusory.

[25] *see, e.g.,* Compl. ¶ 163 ("Defendants acted as part of a conspiracy to profit from violating the law of nations ... in an effort and with the intent to profit from such violations."); *id.* ¶ 165 ("Defendants had the unlawful object[ive] of profiting from violations of [international law]."); *id.* ¶ 173 ("Defendants acted as part of a common design with the Saddam Hussein Regime to violate international law and receive illicit profits which was a direct and proximate cause of the [abuses].").

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TAB 80

917 F.Supp.2d 231
United States District Court,
S.D. New York.

In Re MERIDIAN FUNDS GROUP SECURITIES AND EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA) LITIGATION.

No. 09 M.D.2082.
|
Jan. 7, 2013.

Synopsis
Background: Pension plan brought putative class action asserting claims for securities fraud and violation of the Employee Retirement Income Security Act (ERISA) against investment-fund managers that allegedly lost investors' funds in massive Ponzi scheme. Defendants moved to dismiss.

Holdings: The District Court, Thomas P. Griesa, J., held that:

[1] plan lacked standing to pursue putative class claims on behalf of investors in funds in which plan did not invest;

[2] plan's allegations did not give rise to strong inference that hedge-fund managers acted with scienter, as required to state federal securities fraud claims;

[3] ERISA applied to hedge fund in which plan invested, although plan was organized and headquartered in Cayman islands;

[4] plan adequately alleged that managers were ERISA fiduciaries;

[5] diversion of assets from fund in which plan invested was not prohibited by ERISA; and

[6] plan adequately alleged that managers invested plan's assets under circumstances that gave rise to imprudent level of risk, as required to state ERISA claim that managers breached fiduciary standard of care.

Motion granted in part and denied in part.

Attorneys and Law Firms

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*234 OPINION

THOMAS P. GRIESA, District Judge.

This putative class action arises out of the massive Ponzi scheme orchestrated by Bernard Madoff.

The lead Plaintiff in this case, Pension Trust Fund for Operating Engineers ("Operating Engineers"), is a multi-employer pension plan governed by ERISA. Operating Engineers was an investor in a hedge fund, Meridian Diversified ERISA Fund, Ltd. ("the ERISA Fund"), managed by Meridian Diversified Fund Management, LLC ("Meridian Management"). A portion of this fund's assets was invested in Rye Select Broad Market XL Portfolio Ltd. ("the Rye Portfolio Fund"), managed by Tremont Partners, Inc., which served as a "feeder" fund, investing the fund's assets with Madoff and his investment firm, Bernard L. Madoff Investment Securities LLC ("BMIS"). When Madoff's fraud was discovered, Meridian's entire investment in the Rye Portfolio Fund was lost and, with it, a portion of plaintiff's investment in the ERISA Fund.

The complaint alleges violations of the Securities Act of 1933, the Securities Exchange Act of 1934, the Employee Retirement Income Security Act of 1974, breach of contract, breach of fiduciary duty, unjust enrichment, gross negligence, common law fraud, and negligent misrepresentation.

Defendants move to dismiss all claims. Defendants' motion is granted in part and denied in part.

The Parties

Operating Engineers purchased and held shares worth a total of $125 million in the Meridian Diversified ERISA Fund, Ltd. ("the ERISA Fund") during the class period. (The class period covers shares purchased between March 24, 2004 and December 11, 2008, or held on December 11, 2008.) F.G. Crossthwaite, Operating Engineers' fiduciary, asserts ERISA claims on Operating Engineers' behalf, as required by ERISA § 502. This action is also brought on behalf of all persons similarly situated who purchased shares in funds managed by Meridian Management or one of a number of related entities—Meridian Capital Partners, Inc., ("Meridian Management"), Meridian Diversified Fund, LP, and Meridian Diversified Fund, LLC (collectively, the "Meridian Corporate Defendants")—and who suffered losses as a result of the alleged misconduct described below. Operating Engineers asserts claims not only related to the Meridian Diversified fund they invested in—the ERISA Fund—but also all funds managed by Meridian Corporate Defendants that invested in any Madoff-related entity. [1]

Operating Engineers has sued various Meridian Corporate Defendants. These include Meridian Diversified and Meridian Capital Partners, Inc. These appear also to include Meridian Diversified Fund, LP, and Meridian Diversified Fund, LLC though, presumably due to a drafting mistake, "Meridian Corporate Defendants" is at one point also defined only to include Meridian Diversified and Meridian Capital.

Operating Engineers has also sued various individual defendants who served as executives of Meridian Management and Meridian Capital. These include William Lawrence, Donald Halldin, James Owen, John Sica, Timothy Hickey, Robert Murphy, Howard Fischer, Laura Smith, Peter ***235** Brown, and Mark Hurrell (collectively, "Individual Defendants").

Operating Engineers have also listed Doe defendants representing individuals or entities who may also be liable but whose identities are not yet known.

Standing

[1] As described above, the complaint alleges violations by defendants with respect to eight funds controlled by Meridian Corporate Defendants. *See supra* p. 234. However, as also described above, Operating Engineers only invested in one of these funds, the ERISA Fund. Thus, as to the seven remaining funds, Operating Engineers has suffered no injury.

Operating Engineers is only permitted to pursue claims relating to the Meridian fund in which it actually invested, i.e., the ERISA Fund. Therefore, all claims brought by Operating Engineers on behalf of putative, as yet unnamed class members who did not invest in the ERISA Fund are dismissed. However, because these claims are brought only on behalf of putative class members, there is no impact on the parties named in this lawsuit. It only affects the composition of the putative class and, accordingly, the number of potential claims against defendants.

Operating Engineers' State–Law Claims

Operating Engineers also brings a number of state-law claims on behalf of putative class members who are not ERISA plans. Naturally, because they are not ERISA Plans, these non-ERISA class plaintiffs were invested in funds other than the ERISA Fund in which Operating Engineers had invested.

However, as discussed above, Operating Engineers only has standing to bring claims arising out of its own investment in the ERISA Fund. Therefore, Operating Engineers does not have standing to bring these common law claims on behalf of non-ERISA class plaintiffs who, as Operating Engineers concedes, invested in funds other than the ERISA Fund. Thus, Operating Engineers' claims of breach of fiduciary duty, fraud, unjust enrichment, breach of contract, negligent misrepresentation, and gross negligence (counts 11, 12, 13, 14, 15, and 16, respectively), putatively brought on behalf of non-ERISA class plaintiffs, are dismissed.

Securities Fraud

[2] The foundation of the claim of securities fraud is that investors such as Operating Engineers were led to believe that due diligence would be performed upon the party who managed the Rye Portfolio Fund. In the complaint it is conceded that the party identified as such manager and occupying the post of manager was Tremont Partners, Inc. However, the complaint alleges that funds invested with Rye were turned over directly to Madoff and that Madoff was in reality the manager of how those funds would be invested. Of course, as it turned out, the funds were not actually invested but were used in the Ponzi scheme. But the allegation nevertheless is that, for better or for worse, Madoff was the manager. The claim in the complaint is that the required due diligence could only properly be performed on Madoff, and that no such due diligence was in fact carried on.

As to the above issues, the complaint does not contain the type of allegations, either in form or substance, which should be found in a proper pleading. There are a number of conclusory allegations without the kind of supporting facts which should be pleaded. *See* pars. 49, 51, 54, 55, 77, 79, 80, etc. However, the complaint also contains lengthy quotations said to come from an interview of two Meridian executives conducted by a consulting firm in December, 2008. *See* pars. 85–95. The substance of such an interview would normally ***236** be considered evidence to be introduced at trial, and there are problems with quoting such evidence at length in the allegations of a complaint. However, it is surely true that this interview adds substance to the conclusory allegations made earlier in the complaint.

Taking into account all the relevant portions in the complaint, the court finds that there are sufficient allegations that Madoff was in fact the manager of the funds invested by Operating Engineers and that the Meridian defendants knew that this was so.

However, this does not take us all the way to a proper pleading of securities fraud. A proper complaint must still allege scienter. There is no allegation in the complaint that the Meridian defendants knew of irregularities involving Madoff, much less his Ponzi scheme, at the time Operating Engineers was investing with Meridian. What is alleged, over and over, in the portions of the complaint referred to above, is that Meridian failed to perform due diligence as to Madoff. This, of course, in and of itself does not constitute a claim of fraud. However, the complaint alleges that the Meridian defendants "promised investors they would undertake" a "comprehensive due diligence review of Tremont, Madoff and BMIS." *See* pars 80 and 81.

What is alleged here, at most, is a failure to keep a promise or commitment. But obviously this does not rise to the level of fraud. There is no allegation that, whatever commitments were made regarding due diligence, such commitments were made with some fraudulent intent, specifically with the intent that the diligence would not be performed. In this connection, it is useful to note certain representations made to investors regarding the kind of diligence that was intended, and specific reference here is made to certain qualifications and warnings given to investors. The ERISA fund's Confidential Information Memorandum provided to prospective investors stated:

> The Fund is highly dependent upon the expertise and abilities of the underlying Fund Managers who have investment discretion over the Fund's assets invested with them. Therefore ... the investment decisions made by any Fund Manager or its principals, may adversely affect investment results of the Fund....

The court holds that the complaint does not sufficiently allege all the necessary elements of securities fraud. Therefore, count 1 is dismissed.

Because the plaintiff has not adequately pleaded a claim of securities fraud, the claim for control person liability under section 20(a) (claim 2) is also dismissed.

Count 3, for violation of § 12(a)(2) of the Securities Act, 15 U.S.C. § 77L(a)(2), is also dismissed because § 12(a)(2) only governs public securities offerings. *See Gustafson v. Alloyd Co., Inc.,* 513 U.S. 561, 571, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995). The offerings made by Austin Capital were private.

ERISA Claims

To refresh, Operating Engineers is an ERISA plan and is represented by its named fiduciary. The ERISA Fund invested in by Operating Engineers had a sufficient amount of investment from ERISA plans to transform all the fund's assets into "plan assets" under ERISA. Meridian Management managed the ERISA fund and is a fiduciary for ERISA purposes through its role as investment manager. In addition, because the fund held plan assets, those who exercised control over it may be considered functional (as opposed to named) fiduciaries under ERISA with the same attendant duties ***237** and liability. One of these duties is to prudently manage and invest ERISA plan assets. Another duty is to refrain from engaging in prohibited transactions involving self-dealing of ERISA plan assets.

Operating Engineers first alleges that all defendants are fiduciaries under ERISA via their control of plan assets or by giving investment advice for a fee. Operating Engineers then alleges that defendants breached their ERISA fiduciary duties by failing to prudently manage plan assets and by engaging in prohibited transactions. Defendants argue that the allegations contained in the complaint are insufficient to establish that any defendant except Meridian Management is a fiduciary or that any fiduciary duty was breached.

Application of ERISA to Offshore Investments

[3] As a preliminary matter, defendants have argued that since the ERISA Fund is organized in the Cayman Islands, application of ERISA to it would be a forbidden extraterritorial application of the law.

[4] "When a statute gives no clear indication of an extraterritorial application, it has none." *Morrison v. Nat'l Australia Bank,* ––– U.S. ––––, 130 S.Ct. 2869, 2878, 177 L.Ed.2d 535 (2010). The *Morrison* court applied this presumption against extraterritoriality to hold that Rule 10b–5, promulgated under section 10(b) of the Exchange Act, does not have extraterritorial reach. *Id.* at 2881. Since *Morrison,* courts in this Circuit have held that various federal statutes do not have extraterritorial reach. *See, e.g., Norex Petroleum Ltd. v. Access Indus. Inc.,* 631 F.3d 29, 32 (2d Cir.2010) (RICO).

It is also true, however, that the Supreme Court in *Morrison* explicitly contemplated the applicability of the Exchange Act to the sale of securities listed on an exchange in the United States or sold in the U.S. This "exception" takes cognizance of the fact that the application of the law to such transactions is not, in reality, an extraterritorial application of the law at all. The test for extraterritoriality is not simply whether a foreign entity is made to comply with a provision of U.S. law.

The same is true here. Though the ERISA Fund—and not, it should be emphasized, Meridian Management—was organized and headquartered in the Cayman Islands, there is no suggestion that any material part of the sale occurred there or anywhere else outside of the United States.

It is true that, prior to *Morrison,* courts in other districts had already applied the presumption against extraterritoriality to hold that ERISA does not apply extraterritorially only to claims brought by foreign nationals. *See Chong v. InFocus Corp.,* No. 08 Civ. 500–ST, 2008 WL 5205968, at **5–6, 2008 U.S. Dist. LEXIS 103527, at **16–17 (D.Or. Oct. 24, 2008) (report and recommendation of Magistrate Judge; case settled before District Court could rule on objections); *Giles Maurais v. Snyder,* No. 00–2133, 2000 WL 1368024, at **3–4, 2000 U.S. Dist. LEXIS 13818, at *9 (E.D.Pa. Sept. 14, 2000). In *Chong* the court held that a foreign national had no claim under ERISA (he could not invoke ERISA), and in *Giles* the court held that the foreign plaintiff's state law claims were not preempted by ERISA on the merits (ERISA could not be invoked against him). But cases brought by foreign plaintiffs, such as *Chong* and *Giles,* present an obviously different question from this case, where a domestic plaintiff engaged in an entirely domestic transaction to invest in a fund that happened to be organized offshore.

***238** Moreover, the fund at issue is actually called the "Meridian Diversified ERISA Fund, Ltd." Clearly this fund was designed for and marketed to American investors, in the United States, who sought to invest ERISA-covered funds. Under these circumstances, it would be a truly bizarre result to find that ERISA statute does not apply to claims about investment in this "ERISA Fund" merely because it is organized offshore. ERISA clearly governs this transaction.

Fiduciary Status

[5] **[6]** Liability for imprudence and for engaging in prohibited transactions can only attach to the defendants who were ERISA fiduciaries when imprudent decisions were made or the prohibited transactions were engaged in. *See Pegram v. Herdrich,* 530 U.S. 211, 226, 120 S.Ct. 2143, 147 L.Ed.2d 164 (2000). Thus, in addition to pleading facts sufficient to allege imprudence and an improper transaction, plaintiffs must also allege facts supporting a plausible inference that each defendant was, at the relevant times, an ERISA fiduciary.

ERISA provides that

> a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets; (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such

> plan, or has any authority or responsibility to do so; or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A).

[7] Defendants acknowledge that Meridian Management is an ERISA fiduciary for the ERISA Fund. But defendants argue that Operating Engineers has not adequately pleaded Meridian Capital's status as a fiduciary of the fund. The court concludes, however, that Operating Engineers has sufficiently pleaded that Meridian Capital is an "investment manager" within the meaning of 29 U.S.C. § 1002(38) and that as the managing member of the firm, it has the power to control the investments made by Meridian Management. Plaintiff has also pleaded that Meridian Capital received fees for the rendering of investment advice.

As relates to defendants Meridian Diversified Fund, LLC and Meridian Diversified, LP, Operating Engineers plead no facts at all. However, its briefs have also not discussed the fiduciary status of these defendants and it appears that Operating Engineers does not intend to bring ERISA claims against these defendants. But to the extent Operating Engineers did intend to allege that these two defendants were fiduciaries, it has failed to sufficiently do so.

[8] The complaint also alleges that each individual defendant is an ERISA fiduciary by virtue of their roles as officers and directors of Meridian Management and through providing investment advice for a fee. The offering documents for the ERISA Fund support Operating Engineers' theory that the individual defendants played a role in managing its investments. This includes statements that: Lawrence "overs[aw] all aspects of the firm's investment management function, and provid[ed] strategic leadership"; Sica was "active in the firm's investment and product development activities"; Hickey was "responsible for all aspects of the firm's financial reporting and fund administration function"; and Murphy and Fischer were "responsible for manager research, ***239** due diligence, and monitoring." The complaint also sufficiently alleges that the other individual defendants exercised control over Meridian's investments.

Thus, Operating Engineers' claims that rely on ERISA fiduciary status (counts 4–9) are dismissed as to Meridian Diversified Fund, L.P. and Meridian Diversified Fund, LLC. The complaint sufficiently pleads that the other defendants are fiduciaries under ERISA.

Prohibited Transactions

[9] As noted above, Operating Engineers alleges the diversion of assets by Meridian Management from the ERISA Fund into a segregated portfolio for the purpose of funding a lawsuit against various Tremont entities to recover Meridian Management's losses suffered as a result of Madoff's fraud (count 7). Operating Engineers claims this arrangement is in violation of ERISA § 406(a), which prohibits, *inter alia,* "use by or for the benefit of a party in interest, of any assets of the plan," and § 406(b), which prohibits, *inter alia,* a fiduciary from dealing "with the assets of the plan in his own interest."

Defendants do not deny that such a diversion took place, but they argue that the transaction was not with "a party in interest" and so does not violate ERISA § 406(a) and that the transaction is for the benefit of investors and so does not violate § 406(b). Defendants claim the segregated portfolio benefits investors because any recovery as a result of the litigation funded by the portfolio will be passed on to investors. The Second Circuit, in *State St. Bank & Trust v. Salovaara,* 326 F.3d 130, 137 (2d Cir.2003), interpreted ERISA § 408(c) to allow a fiduciary to be reimbursed, through plan assets, for the legal costs of initiating lawsuits, when such suits are properly incurred in the performance of the fiduciary's duties with respect the plan. The court further stated that a legal expense is "properly" incurred when the fiduciary initiated the lawsuits as part of his duties with the fund and with an "eye single" towards the benefit of the fund. *Id.* at 139.

Here, the lawsuits brought by Meridian Management against Tremont are for the benefit of investors like Operating Investors because the lawsuits are attempting to recover a portion of Operating Engineers' investment that would otherwise be lost. This is just the type of activity that may be funded from plan assets according to the court in *State St.*

Therefore, count 7 is dismissed with respect to all defendants.

Prudence

[10] **[11]** As discussed previously, the complaint alleges, in short, that by missing or not paying sufficient attention to the red flags of Madoff's operation, defendants failed to invest and/or manage ERISA assets in a prudent manner, in violation of ERISA § 404(a)(1)(B). With such claims, the issue is whether a plaintiff's allegations support an inference that the ERISA fiduciaries made investment decisions under circumstances that gave rise to an imprudent level of risk. *See In re Morgan Stanley Info. Fund Sec. Litig.,* 592 F.3d 347, 364 (2d Cir.2010).

[12] The ERISA prudence standard is one of the highest duties known to the law. *Donovan v. Bierwirth,* 680 F.2d 263, 272 n. 8 (2d Cir.1982), *cert. denied,* 459 U.S. 1069, 103 S.Ct. 488, 74 L.Ed.2d 631 (1982). This standard does not require merely the level of care expected of a prudent layperson, but rather that of a prudent fiduciary with experience in dealing with a similar enterprise. *United States v. Mason Tenders Dist. Council of Greater New York,* 909 F.Supp. 882, 886 (S.D.N.Y.1995).

> ***240** Courts have construed ERISA's prudent person standard as an objective standard, requiring the fiduciary (1) to employ proper methods to investigate, evaluate and structure the investment; (2) to act in a manner as would others who have a capacity and familiarity with such matters; and (3) to exercise independent judgment when making investment decisions.

Bd. of Trustees of Local 295/Local 851–IBT Emp'r Pension Fund v. Callan Assocs., Inc., 97 Civ. 1741, 1998 WL 289697 (S.D.N.Y. June 4, 1998) *aff'd sub nom. Bd. of Trustees of Local 295/Local 851–IBT Emp'r Group Pension Fund & Local 295/Local 851–IBT Emp'r Group Welfare Fund v. Callan Assocs., Inc.,* 175 F.3d 1007 (2d Cir.1999).

However, the court must take care not to judge the defendants' behavior with the benefit of hindsight. *Chao v. Merino,* 452 F.3d 174, 182 (2d Cir.2006).

In this case, prudence is measured against hypothetical sophisticated and prudent investment professionals with experience controlling and managing large hedge funds. Thus, the proper question to focus on is whether a prudent, sophisticated investment professional with experience in controlling large hedge funds and faced with the same facts, would have acted in a similar fashion as defendants.

In answering this question, the court is particularly impressed by the allegation that Madoff's returns, based on his advertised investment strategy, were mathematically impossible—a fact allegedly recognized by other investment managers before the fraud was revealed to the wider world. Plaintiffs allege that the defendants knew that Madoff was the person actually managing their investment and that they knew, in at least broad terms, the strategy Madoff purported to be following. Therefore, as sophisticated investors, defendants should have been aware of this and other red flags which should have set off alarms and made defendants question their investment. Thus, defendants' unawareness of, or blindness to, this particular anomaly raises a significant question as to whether defendants, at the various decision points, were as careful as they should have been in making their investment decisions in light of the information available. *See Donovan,* 680 F.2d at 271–73; *In re Beacon,* 745 F.Supp.2d 386, 419 (S.D.N.Y.2010) (allegations that defendants failed to act on knowledge of material risk to fund was enough to support inference of imprudence). Moreover, defendants continued to invest in Madoff's funds through Tremont for many years, raising further questions as to the prudence they exercised.

For the above reasons, Operating Engineers has adequately alleged imprudence. Thus, the motion to dismiss is denied as to counts 4, 5, and 6 as to all defendants except Meridian Diversified Fund, L.P. and Meridian Diversified Fund, LLC. Counts 4, 5, and 6 are dismissed as to these two defendants.

Co-fiduciary Liability

The allegations underlying the claim for primary breach of fiduciary duty, which this court has found sufficient to survive the motion to dismiss, also support a claim for co-fiduciary liability. Therefore, like the breach of ERISA fiduciary duty claim, the motion to dismiss the claim for breach of co-fiduciary duty (count 8) is granted only as to Meridian Diversified Fund, L.P. and Meridian Diversified Fund, LLC. It is denied as to count 8 in all other respects.

Disgorgement

Operating Engineers bring separate claims for disgorgement under ERISA § 502(a)(3) against any defendant determined ***241** to be a fiduciary (count 9) and any defendant determined not to be a fiduciary (count 10). As to fiduciaries, disgorgement is a remedy for breach of fiduciary duty, not a separate cause of action. Thus, count 9 is dismissed as duplicative of counts 4–6. However, count 10, the disgorgement claim against non-fiduciaries, has been sufficiently pleaded for purposes of this motion.

CONCLUSION

The motion to dismiss is granted as to all counts with respect to Meridian Diversified Fund, L.P. and Meridian Diversified Fund, LLC. The motion to dismiss as to the other defendants is granted as to all counts except 4, 5, 6, 8 and 10.

All Citations

917 F.Supp.2d 231, Fed. Sec. L. Rep. P 97,253, 55 Employee Benefits Cas. 2920

Footnotes

[1] These other funds are the Meridian Horizon Fund, LP; the Meridian Horizon Fund II, LP; the Meridian Diversified Fund, LP; the Meridian Diversified Fund, Ltd.; the Meridian Diversified Compass Fund, Ltd.; the Meridian Absolute Return ERISA Fund, Ltd.; and the Kingate Global Fund, Ltd.

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TAB 81

132 S.Ct. 740
Supreme Court of the United States

Marcus D. MIMS, Petitioner
v.
ARROW FINANCIAL SERVICES, LLC.

No. 10–1195.
|
Argued Nov. 28, 2011.
|
Decided Jan. 18, 2012.

Synopsis
Background: Consumer brought private action against financial services company, alleging violation of Telephone Consumer Protection Act (TCPA). The United States District Court for the Southern District of Florida granted company's motion to dismiss for lack of subject matter jurisdiction, on theory that state courts had exclusive jurisdiction over such private causes of action under the TCPA, and consumer appealed. The Eleventh Circuit Court of Appeals, 421 Fed.Appx. 920, affirmed. Certiorari was granted.

[Holding:] The Supreme Court, Justice Ginsburg, held that federal and state courts have concurrent jurisdiction over private suits arising under the TCPA; abrogating *Nicholson v. Hooters of Augusta, Inc.,* 136 F.3d 1287; *Murphey v. Lanier,* 204 F.3d 911; *ErieNet, Inc. v. Velocity Net, Inc.,* 156 F.3d 513; *Foxhall Realty Law Offices, Inc. v. Telecommunications Premium Servs., Ltd.,* 156 F.3d 432; *Chair King, Inc. v. Houston Cellular Corp.,* 131 F.3d 507; and *International Science & Technology Inst. v. Inacom Communications, Inc.,* 106 F.3d 1146.

Reversed and remanded.

***742** *Syllabus* [*]

Consumer complaints about abuses of telephone technology—for example, computerized calls to private homes—prompted Congress to pass the Telephone Consumer Protection Act of 1991 (TCPA or Act), 47 U.S.C. § 227. Congress determined that federal legislation was needed because telemarketers, by operating interstate, were escaping state-law prohibitions on intrusive nuisance calls. The Act bans certain invasive telemarketing practices and directs the Federal Communications Commission (FCC) to prescribe implementing regulations. It authorizes States to bring civil actions to enjoin prohibited practices and recover damages on their residents' behalf, 47 U.S.C.A. § 227(g)(1) (Supp.2011), and provides that jurisdiction over these state-initiated suits lies exclusively in the U.S. district courts, § 227(g)(2). It also permits a private person to seek redress for violations of the Act or regulations "in an appropriate court of [a] State," "if [such an action is] otherwise permitted by the laws or rules of court of [that] State." 47 U.S.C. § 227(b)(3), (c)(5).

Petitioner Mims filed a damages action in Federal District Court, alleging that respondent Arrow, seeking to collect a debt, violated the TCPA by repeatedly using an automatic telephone dialing system or prerecorded or artificial voice to call Mims's cellular phone without his consent. Mims invoked the court's "federal question" jurisdiction, *i.e.,* its authority to adjudicate claims "arising under the ... laws ... of the United States," 28 U.S.C. § 1331. The District Court, affirmed by the Eleventh Circuit, dismissed Mims's complaint for want of subject-matter jurisdiction, concluding that the TCPA had vested jurisdiction over private actions exclusively in state courts.

Held: The TCPA's permissive grant of jurisdiction to state courts does not deprive the U.S. district courts of federal-question jurisdiction over private TCPA suits. Pp. 747 – 753.

(a) Because federal law creates the right of action and provides the rules of decision, Mims's TCPA claim, in § 1331's words, plainly "aris[es] under" the "laws ... of the United States." Arrow agrees that this action arises under federal law, but urges that Congress vested exclusive adjudicatory authority over private TCPA actions in state courts. In cases "arising under" federal law, there is a presumption of concurrent state-court jurisdiction, rebuttable if "Congress affirmatively ousts the state courts of jurisdiction over a particular federal claim." *Tafflin v. Levitt,* 493 U.S. 455, 458–459, 110 S.Ct. 792, 107 L.Ed.2d 887. Arrow acknowledges the presumption, but maintains that § 1331 creates no converse presumption in favor of federal-court jurisdiction. Instead, Arrow urges, the TCPA, a later, more specific statute, displaces § 1331, an earlier, more general prescription.

Section 1331 is not swept away so easily. The principle that district courts possess federal-question jurisdiction under § 1331 when federal law creates a private right of action and furnishes the substantive rules of decision endures unless Congress divests federal courts of their § 1331 adjudicatory authority. See, *e.g., Verizon* ***743** *Md. Inc. v. Public Serv. Comm'n of Md.,* 535 U.S. 635, 642, 122 S.Ct. 1753, 152 L.Ed.2d 871. Accordingly, the District Court retains § 1331 jurisdiction over Mims's complaint unless the TCPA, expressly or by fair implication, excludes federal-court adjudication. See *id.,* at 644, 122 S.Ct. 1753. Pp. 747 – 749.

(b) Arrow's arguments do not persuade this Court that Congress eliminated § 1331 jurisdiction over private TCPA actions. Title 47 U.S.C. § 227(b)(3)'s language may be state-court oriented, but "the grant of jurisdiction to one court does not, of itself, imply that the jurisdiction is to be exclusive," *United States v. Bank of New York & Trust Co.,* 296 U.S. 463, 479, 56 S.Ct. 343, 80 L.Ed. 331. Nothing in § 227(b)(3)'s permissive language makes state-court jurisdiction exclusive, or otherwise purports to oust federal courts of their § 1331 jurisdiction. The provision does not state that a private plaintiff may bring a TCPA action "only" or "exclusively" in state court. In contrast, 47 U.S.C.A. § 227(g)(2) (Supp.2011) vests "exclusive jurisdiction" over state-initiated TCPA suits in the federal courts. Section 227(g)(2)'s exclusivity prescription "reinforce[s] the conclusion that [47 U.S.C. § 227(b)(3)'s] silence ... leaves the jurisdictional grant of § 1331 untouched. For where otherwise applicable jurisdiction was meant to be excluded, it was excluded expressly." *Verizon Md.,* 535 U.S., at 644, 122 S.Ct. 1753.

Arrow argues that Congress had no reason to provide for a private action "in an appropriate [state] court," § 227(b)(3), if it did not mean to make the state forum exclusive, for state courts would have concurrent jurisdiction even if Congress had said nothing at all. But, as already noted, Congress had simultaneously made federal-court jurisdiction exclusive in TCPA enforcement actions brought by state authorities, see 47 U.S.C.A. § 227(g)(2) (Supp.2011), and may simply have wanted to avoid any argument that federal jurisdiction was also exclusive for private actions. Moreover, by providing that private actions may be brought in state court "if otherwise permitted by the laws or rules of court of [the] State," 47 U.S.C. § 227(b)(3), Congress arguably gave States leeway they would otherwise lack to decide whether to entertain TCPA claims.

Arrow further asserts that making state-court jurisdiction over § 227(b)(3) claims exclusive serves Congress' objective of enabling States to control telemarketers whose interstate operations evaded state law. Even so, jurisdiction conferred by 28 U.S.C. § 1331 should hold firm against "mere implication flowing from subsequent legislation." *Colorado River Water Conservation Dist. v. United States,* 424 U.S. 800, 808, 809, n. 15, 96 S.Ct. 1236, 47 L.Ed.2d 483. Furthermore, had Congress sought only to fill a gap in the States' enforcement capabilities, it could have provided that out-of-state telemarketing calls directed into a State would be subject to the receiving State's laws. Instead, Congress enacted detailed, uniform, federal substantive prescriptions and provided for a regulatory regime administered by a federal agency.

Arrow's reliance on a statement by Senator Hollings, the TCPA's sponsor, is misplaced. The remarks nowhere mention federal-court jurisdiction or otherwise suggest that 47 U.S.C. § 227(b)(3) is intended to divest federal courts of authority over TCPA claims. Even if Hollings and other TCPA supporters expected private actions to proceed solely in state courts, their expectation would not control this Court's judgment on § 1331's compass. Arrow's arguments that federal courts will be inundated by $500–per–violation TCPA claims or that defendants could use federal-court removal to force small-claims-court plaintiffs ***744** to abandon suit seem more imaginary than real. Pp. 749 – 753.

421 Fed.Appx. 920, reversed and remanded.

GINSBURG, J., delivered the opinion for a unanimous Court.

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Opinion

Justice GINSBURG delivered the opinion of the Court.

This case concerns enforcement, through private suits, of the Telephone Consumer Protection Act of 1991 (TCPA or Act), 47 U.S.C. § 227. Voluminous consumer complaints about abuses of telephone technology—for example, computerized calls dispatched to private homes—prompted Congress to pass the TCPA. Congress determined that federal legislation was needed because telemarketers, by operating interstate, were escaping state-law prohibitions on intrusive nuisance calls. The Act bans certain practices invasive of privacy and directs the Federal Communications Commission (FCC or Commission) to prescribe implementing regulations. It authorizes States to bring civil actions to enjoin prohibited practices and to recover damages on their residents' behalf. The Commission must be notified of such suits and may intervene in them. Jurisdiction over state-initiated TCPA suits, Congress provided, lies exclusively in the U.S. district courts. Congress also provided for civil actions by private parties seeking redress for violations of the TCPA or of the Commission's implementing regulations.

Petitioner Marcus D. Mims, complaining of multiple violations of the Act by respondent Arrow Financial Services, LLC (Arrow), a debt-collection agency, commenced an action for damages against Arrow in the U.S. District Court for the Southern District of Florida. Mims invoked the court's "federal question" jurisdiction, *i.e.,* its authority to adjudicate claims "arising under the ... laws ... of the United States," 28 U.S.C. § 1331. The District Court, affirmed by the U.S. Court of Appeals for the Eleventh Circuit, dismissed Mims's complaint for want of subject-matter jurisdiction. Both courts relied on Congress' specification, in the TCPA, that a private person may seek redress for violations of the Act (or of the Commission's regulations thereunder) "in an appropriate court of [a] State," "if [such an action is] otherwise permitted by the laws or rules of court of [that] State." 47 U.S.C. § 227(b)(3), (c)(5).

The question presented is whether Congress' provision for private actions to enforce the TCPA renders state courts the *exclusive* arbiters of such actions. We have long recognized that "[a] suit arises under the law that creates the cause of action." *American Well Works Co. v. Layne & Bowler Co.,* 241 U.S. 257, 260, 36 S.Ct. 585, 60 L.Ed. 987 (1916). Beyond ***745** doubt, the TCPA is a federal law that both creates the claim Mims has brought and supplies the substantive rules that will govern the case. We find no convincing reason to read into the TCPA's permissive grant of jurisdiction to state courts any barrier to the U.S. district courts' exercise of the general federal-question jurisdiction they have possessed since 1875. See Act of Mar. 3, 1875, § 1, 18 Stat. 470; 13D C. Wright, A. Miller, E. Cooper, & R. Freer, Federal Practice and Procedure § 3561, p. 163 (3d ed. 2008) (hereinafter Wright & Miller). We hold, therefore, that federal and state courts have concurrent jurisdiction over private suits arising under the TCPA.

I

A

In enacting the TCPA, Congress made several findings relevant here. "Unrestricted telemarketing," Congress determined, "can be an intrusive invasion of privacy." TCPA, 105 Stat. 2394, note following 47 U.S.C. § 227 (Congressional Findings) (internal quotation marks omitted). In particular, Congress reported, "[m]any consumers are outraged over the proliferation of intrusive, nuisance [telemarketing] calls to their homes." *Ibid.* (internal quotation marks omitted). "[A]utomated or prerecorded telephone calls" made to private residences, Congress found, were rightly regarded by recipients as "an invasion of privacy." *Ibid.* (internal quotation marks omitted). Although over half the States had enacted statutes restricting telemarketing, Congress believed that federal law was needed because "telemarketers [could] evade [state-law] prohibitions through interstate operations." *Ibid.* (internal quotation marks omitted). See also S.Rep. No. 102–178, p. 3 (1991), 1991 U.S.C.C.A.N. 1968, 1970 ("[B]ecause States do not have jurisdiction over interstate calls[,] [m]any States have expressed a desire for Federal legislation....").[1]

Subject to exceptions not pertinent here, the TCPA principally outlaws four practices. First, the Act makes it unlawful to use an automatic telephone dialing system or an artificial or prerecorded voice message, without the prior express consent of the called party, to call any emergency telephone line, hospital patient, pager, cellular telephone, or other service for which the receiver is charged for the call. See 47 U.S.C. § 227(b)(1)(A). Second, the TCPA forbids using artificial or prerecorded voice messages to call residential telephone lines without prior express consent. § 227(b)(1)(B). Third, the Act proscribes sending unsolicited advertisements to fax machines. § 227(b)(1)(C). Fourth, it bans using automatic telephone dialing systems to engage two or more of a business' telephone lines simultaneously. § 227(b)(1)(D).[2]

***746** The TCPA delegates authority to the FCC to ban artificial and prerecorded voice calls to businesses, § 227(b)(2)(A), and to exempt particular types of calls from the law's requirements, § 227(b)(2)(B), (C). The Act also directs the FCC to prescribe regulations to protect the privacy of residential telephone subscribers, possibly through the creation of a national "do not call" system. § 227(c).[3]

Congress provided complementary means of enforcing the Act. State Attorneys General may "bring a civil action on behalf of [State] residents," if the Attorney General "has reason to believe that any person has engaged ... in a pattern or practice" of violating the TCPA or FCC regulations thereunder. 47 U.S.C.A. § 227(g)(1) (Supp.2011). "The district courts of the United States ... have exclusive jurisdiction" over all TCPA actions brought by State Attorneys General. § 227(g)(2). The Commission may intervene in such suits. § 227(g)(3).[4]

Title 47 U.S.C. § 227(b)(3), captioned "Private right of action," provides:

> "A person or entity may, if otherwise permitted by the laws or rules of court of a State, bring in an appropriate court of that State—
>
> "(A) an action based on a violation of this subsection or the regulations prescribed under this subsection to enjoin such violation,
>
> "(B) an action to recover for actual monetary loss from such a violation, or to receive $500 in damages for each such violation, whichever is greater, or
>
> "(C) both such actions.
>
> "If the court finds that the defendant willfully or knowingly violated this subsection or the regulations prescribed under this subsection, the court may, in its discretion, increase the amount of the award to an amount equal to not more than 3 times the amount available under subparagraph (B) of this paragraph."

A similar provision authorizes a private right of action for a violation of the FCC's implementing regulations. [5]

B

Mims, a Florida resident, alleged that Arrow, seeking to collect a debt, repeatedly used an automatic telephone dialing system or prerecorded or artificial voice to call Mims's cellular phone without his consent. Commencing suit in the U.S. District Court for the Southern District of Florida, Mims charged that Arrow "willfully or knowingly violated the TCPA." App. 14. He sought declaratory relief, a permanent ***747** injunction, and damages. *Id.,* at 18–19.

The District Court held that it lacked subject-matter jurisdiction over Mims's TCPA claim. Under Eleventh Circuit precedent, the District Court explained, federal-question jurisdiction under 28 U.S.C. § 1331 was unavailable "because Congress vested jurisdiction over [private actions under] the TCPA exclusively in state courts." Civ. No. 09–22347 (SD Fla., Apr. 1, 2010), App. to Pet. for Cert. 4a–5a (citing *Nicholson v. Hooters of Augusta, Inc.,* 136 F.3d 1287 (C.A.11 1998)). Adhering to Circuit precedent, the U.S. Court of Appeals for the Eleventh Circuit affirmed. 421 Fed.Appx. 920, 921 (2010) (quoting *Nicholson,* 136 F.3d, at 1287–1288 ("Congress granted state courts exclusive jurisdiction over private actions under the [TCPA].")).

[1] We granted certiorari, 564 U.S. ——, 131 S.Ct. 3063, 180 L.Ed.2d 884 (2011), to resolve a split among the Circuits as to whether Congress granted state courts exclusive jurisdiction over private actions brought under the TCPA. Compare *Murphey v. Lanier,* 204 F.3d 911, 915 (C.A.9 2000) (U.S. district courts lack federal-question jurisdiction over private TCPA actions), *ErieNet, Inc. v. Velocity Net, Inc.*, 156 F.3d 513, 519 (C.A.3 1998) (same), *Foxhall Realty Law Offices, Inc. v. Telecommunications Premium Servs., Ltd.,* 156 F.3d 432, 434 (C.A.2 1998) (same), *Nicholson,* 136 F.3d, at 1287–1288, *Chair King, Inc. v. Houston Cellular Corp.,* 131 F.3d 507, 514 (C.A.5 1997) (same), and *International Science & Technology Inst. v. Inacom Communications, Inc.,* 106 F.3d 1146, 1158 (C.A.4 1997) (same), with *Charvat v. EchoStar Satellite, LLC,* 630 F.3d 459, 463–465 (C.A.6 2010) (U.S. district courts have federal-question jurisdiction over private TCPA actions), *Brill v. Countrywide Home Loans, Inc.,* 427 F.3d 446, 447 (C.A.7 2005) (same), and *ErieNet,* 156 F.3d, at 521 (Alito, J., dissenting) (same). We now hold that Congress did not deprive federal courts of federal-question jurisdiction over private TCPA suits.

II

[2] Federal courts, though "courts of limited jurisdiction," *Kokkonen v. Guardian Life Ins. Co. of America,* 511 U.S. 375, 377, 114 S.Ct. 1673, 128 L.Ed.2d 391 (1994), in the main "have no more right to decline the exercise of jurisdiction which is given, then to usurp that which is not given." *Cohens v. Virginia,* 6 Wheat. 264, 5 L.Ed. 257 (1821). Congress granted federal courts general federal-question jurisdiction in 1875. See Act of Mar. 3, 1875, § 1, 18 Stat. 470.[6] As now codified, the law provides: "The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." 28 U.S.C. § 1331. The statute originally included an amount-in-controversy requirement, set at $500. See Act of Mar. 3, 1875, § 1, 18 Stat. 470. Recognizing the responsibility of federal courts to decide claims, large or small, arising under federal law, Congress in 1980 eliminated the amount-in-controversy requirement in federal-question (but not diversity) cases. See Federal Question Jurisdictional Amendments Act of 1980, 94 Stat. 2369 (amending 28 U.S.C. § 1331). See also ***748** H.R.Rep. No. 96–1461, p. 1 (1980).[7] Apart from deletion of the amount-in-controversy requirement, the general federal-question provision has remained essentially unchanged since 1875. See 13D Wright & Miller 163.

[3] Because federal law creates the right of action and provides the rules of decision, Mims's TCPA claim, in 28 U.S.C. § 1331's words, plainly "aris [es] under" the "laws ... of the United States." As already noted, *supra,* at 744, "[a] suit arises under the law that creates the cause of action." *American Well Works,* 241 U.S., at 260, 36 S.Ct. 585. Although courts have described this formulation as "more useful for inclusion than for ... exclusion," *Merrell Dow Pharmaceuticals Inc. v. Thompson,* 478 U.S. 804, 809, n. 5, 106 S.Ct. 3229, 92 L.Ed.2d 650 (1986) (quoting *T.B. Harms Co. v. Eliscu,* 339 F.2d 823, 827 (C.A.2 1964)), there is no serious debate that a federally created claim for relief is generally a "sufficient condition for federal-question jurisdiction." *Grable & Sons Metal Products, Inc. v. Darue Engineering & Mfg.,* 545 U.S. 308, 317, 125 S.Ct. 2363, 162 L.Ed.2d 257 (2005).[8]

[4] **[5]** Arrow agrees that this action arises under federal law, see Tr. of Oral Arg. 27, but urges that Congress vested exclusive adjudicatory authority over private TCPA actions in state courts. In cases "arising under" federal law, we note, there is a "deeply rooted presumption in favor of concurrent state court jurisdiction," rebuttable if "Congress affirmatively ousts the state courts of jurisdiction over a particular federal claim." *Tafflin v. Levitt,* 493 U.S. 455, 458–459, 110 S.Ct. 792, 107 L.Ed.2d 887 (1990). *E.g.,* 28 U.S.C. § 1333 ("The district courts shall have original jurisdiction, exclusive of the courts of the States, of: (1) Any civil case of admiralty or maritime jurisdiction...."). The presumption of concurrent state-court jurisdiction, we have recognized, can be overcome "by an explicit statutory directive, by unmistakable implication from legislative history, or by a clear incompatibility between state-court jurisdiction and federal interests." *Gulf Offshore Co. v. Mobil Oil Corp.,* 453 U.S. 473, 478, 101 S.Ct. 2870, 69 L.Ed.2d 784 (1981).

Arrow readily acknowledges the presumption of concurrent state-court jurisdiction, but maintains that 28 U.S.C. § 1331 creates no converse presumption in favor of federal-court jurisdiction. Instead, Arrow urges, the TCPA, a later, more specific statute, displaces § 1331, an earlier, more general prescription. See Tr. of Oral Arg. 28–29; Brief for Respondent 31.

[6] **[7]** Section 1331, our decisions indicate, is not swept away so easily. As stated earlier, see *supra,* at 748, when federal law creates a private right of action ***749** and furnishes the substantive rules of decision, the claim arises under federal law, and district courts possess federal-question jurisdiction under § 1331.[9] That principle endures unless Congress divests federal courts of their § 1331 adjudicatory authority. See, *e.g., Verizon Md. Inc. v. Public Serv. Comm'n of Md.,* 535 U.S. 635, 642, 122 S.Ct. 1753, 152 L.Ed.2d 871 (2002) (Nothing in 47 U.S.C. § 252(e)(6) "*divest[s]* the district courts of their authority under 28 U.S.C. § 1331 to review the [state agency's] order for compliance with federal law."); *Kmart Corp. v. Cartier, Inc.,* 485 U.S. 176, 182–183, 108 S.Ct. 950, 99 L.Ed.2d 151 (1988) ("The District Court would be divested of [§ 1331] jurisdiction ... if this action fell within one of several specific grants of exclusive jurisdiction to the Court of International Trade [under 28 U.S.C. § 1581(a) or § 1581(i)(3)].").

[8] [9] "[D]ivestment of district court jurisdiction" should be found no more readily than "divestmen[t] of state court jurisdiction," given "the longstanding and explicit grant of federal question jurisdiction in 28 U.S.C. § 1331." *ErieNet,* 156 F.3d, at 523 (Alito, J., dissenting); see Gonell, Note, Statutory Interpretation of Federal Jurisdictional Statutes: Jurisdiction of the Private Right of Action under the TCPA, 66 Ford. L.Rev. 1895, 1929–1930 (1998). Accordingly, the District Court retains § 1331 jurisdiction over Mims's complaint unless the TCPA, expressly or by fair implication, excludes federal-court adjudication. See *Verizon Md.,* 535 U.S., at 644, 122 S.Ct. 1753; Gonell, *supra,* at 1929 (Jurisdiction over private TCPA actions "is proper under § 1331 unless Congress enacted a partial repeal of § 1331 in the TCPA.").

III

Arrow's arguments do not persuade us that Congress has eliminated § 1331 jurisdiction over private actions under the TCPA.

[10] The language of the TCPA—"A person or entity may, if otherwise permitted by the laws or rules of court of a State, bring [an action] in an appropriate court of that State," 47 U.S.C. § 227(b)(3)—Arrow asserts, is uniquely state-court oriented. See Brief for Respondent 13. That may be, but "[i]t is a general rule that the grant of jurisdiction to one court does not, of itself, imply that the jurisdiction is to be exclusive." *United States v. Bank of New York & Trust Co.,* 296 U.S. 463, 479, 56 S.Ct. 343, 80 L.Ed. 331 (1936).

Nothing in the permissive language of § 227(b)(3) makes state-court jurisdiction exclusive, or otherwise purports to oust federal courts of their 28 U.S.C. § 1331 jurisdiction over federal claims. See, *e.g., Verizon Md.,* 535 U.S., at 643, 122 S.Ct. 1753 ("[N]othing in 47 U.S.C. § 252(e)(6) purports to strip [§ 1331] jurisdiction."). Cf. *Yellow Freight System, Inc. v. Donnelly,* 494 U.S. 820, 823, 110 S.Ct. 1566, 108 L.Ed.2d 834 (1990) (Title VII's language—"[e]ach United States district court ... shall have jurisdiction of actions brought under this subchapter," 42 U.S.C. § 2000e–5(f)(3)—does not "ous[t] state courts of their presumptive jurisdiction." (internal quotation marks omitted)). Congress may indeed provide a track for a federal claim exclusive of § 1331. See, *e.g.,* 42 U.S.C. § 405(h) ("No action ... shall be brought under [§ 1331] to recover on any claim arising under [Title II of the Social Security Act]."); *Weinberger v. Salfi,* ***750** 422 U.S. 749, 756–757, 95 S.Ct. 2457, 45 L.Ed.2d 522 (1975). Congress has done nothing of that sort here, however.

Title 47 U.S.C. § 227(b)(3) does not state that a private plaintiff may bring an action under the TCPA "only" in state court, or "exclusively" in state court. The absence of such a statement contrasts with the Act's instruction on suits instituted by State Attorneys General. As earlier noted, see *supra,* at 745 – 746, 47 U.S.C.A. § 227(g)(2) (Supp.2011) vests "exclusive jurisdiction over [such] actions" in "[t]he district courts of the United States." [10] Section 227(g)(2)'s exclusivity prescription "reinforce[s] the conclusion that [47 U.S.C. § 227(b)(3)'s] silence ... leaves the jurisdictional grant of § 1331 untouched. For where otherwise applicable jurisdiction was meant to be excluded, it was excluded expressly." *Verizon Md.,* 535 U.S., at 644, 122 S.Ct. 1753; see *ErieNet,* 156 F.3d, at 522 (Alito, J., dissenting) ("[47 U.S.C.A. § 227(g)(2) (Supp.2011)] reveals that, while drafting the TCPA, Congress knew full well how to grant exclusive jurisdiction with mandatory language. The most natural interpretation of Congress' failure to use similar language in [47 U.S.C. §]227(b)(3) is that Congress did not intend to grant exclusive jurisdiction in that section."); *Brill,* 427 F.3d, at 451 ("[47 U.S.C.A. § 227(g)(2) (Supp.2011)] is explicit about exclusivity, while [47 U.S.C.] § 227(b)(3) is not; the natural inference is that the state forum mentioned in § 227(b)(3) is optional rather than mandatory."). [11]

[11] [12] [13] Arrow urges that Congress would have had no reason to provide for a private action "in an appropriate [state] court," § 227(b)(3), if it did not mean to make the state forum exclusive. Had Congress said nothing at all about bringing private TCPA claims in state courts, Arrow observes, those courts would nevertheless have concurrent jurisdiction. See *supra,* at 748 – 749. True enough, but Congress had simultaneously provided for TCPA enforcement actions by state authorities, 47 U.S.C.A. § 227(g) (Supp.2011), and had made federal district courts exclusively competent in such cases, § 227(g)(2). Congress may simply have wanted to avoid any argument that in private actions, as in actions brought by State Attorneys General, "federal jurisdiction is exclusive." *Brill,* 427 F.3d, at 451 (emphasis deleted) (citing ***751** *Yellow Freight,* 494 U.S. 820, 110 S.Ct. 1566, 108 L.Ed.2d 834 (holding, after 26 years of litigation, that claims under the Civil Rights Act of 1964 may be resolved in state as well as federal courts) and *Tafflin,* 493 U.S. 455, 110 S.Ct. 792 (holding, after 20 years of litigation, that claims under RICO may be resolved in state as well as federal courts)). Moreover, by providing that private actions may be brought in state court "if otherwise permitted by the laws or rules of court of [the] State," 47 U.S.C. § 227(b)(3), Congress arguably gave States leeway they would otherwise lack to "decide for [themselves] whether to entertain claims under the [TCPA]," *Brill,* 427 F.3d, at 451. See Brief for Respondent 16 (Congress "le[ft] States free to decide what TCPA claims to allow."). [12]

[14] Making state-court jurisdiction over § 227(b)(3) claims exclusive, Arrow further asserts, "fits hand in glove with [Congress'] objective": enabling States to control telemarketers whose interstate operations evaded state law. *Id.*, at 15. Even so, we have observed, jurisdiction conferred by 28 U.S.C. § 1331 should hold firm against "mere implication flowing from subsequent legislation." *Colorado River Water Conservation Dist. v. United States,* 424 U.S. 800, 808, 809, n. 15, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976) (quoting *Rosencrans v. United States,* 165 U.S. 257, 262, 17 S.Ct. 302, 41 L.Ed. 708 (1897)).

We are not persuaded, moreover, that Congress sought only to fill a gap in the States' enforcement capabilities. Had Congress so limited its sights, it could have passed a statute providing that out-of-state telemarketing calls directed into a State would be subject to the laws of the receiving State. Congress did not enact such a law. Instead, it enacted detailed, uniform, federal substantive prescriptions and provided for a regulatory regime administered by a federal agency. See 47 U.S.C. § 227. TCPA liability thus depends on violation of a federal statutory requirement or an FCC regulation, § 227(b)(3)(A), (c)(5), not on a violation of any state substantive law.

The federal interest in regulating telemarketing to "protec[t] the privacy of individuals" while "permit[ting] legitimate [commercial] practices," 105 Stat. 2394, note following 47 U.S.C. § 227 (Congressional Findings) (internal quotation marks omitted), is evident from the regulatory role Congress assigned to the FCC. See, *e.g.,* § 227(b)(2) (delegating to the FCC authority to exempt calls from the Act's reach and prohibit calls to businesses). Congress' design would be less well served if consumers had to rely on "the laws or rules of court of a State," § 227(b)(3), or the accident of diversity jurisdiction, [13] to gain redress for TCPA violations.

***752** Arrow emphasizes a statement made on the Senate floor by Senator Hollings, the TCPA's sponsor:

> "Computerized calls are the scourge of modern civilization. They wake us up in the morning; they interrupt our dinner at night; they force the sick and elderly out of bed; they hound us until we want to rip the telephone right out of the wall.
>
> .....
>
> "The substitute bill contains a private right-of-action provision that will make it easier for consumers to recover damages from receiving these computerized calls. The provision would allow consumers to bring an action in State court against any entity that violates the bill. The bill does not, because of constitutional constraints, dictate to the States which court in each State shall be the proper venue for such an action, as this is a matter for State legislators to determine. Nevertheless, it is my hope that States will make it as easy as possible for consumers to bring such actions, preferably in small claims court....
>
> "Small claims court or a similar court would allow the consumer to appear before the court without an attorney. The amount of damages in this legislation is set to be fair to both the consumer and the telemarketer. However, it would defeat the purposes of the bill if the attorneys' costs to consumers of bringing an action were greater than the potential damages. I thus expect that the States will act reasonably in permitting their citizens to go to court to enforce this bill." 137 Cong. Rec. 30821–30822 (1991).

This statement does not bear the weight Arrow would place on it.

[15] First, the views of a single legislator, even a bill's sponsor, are not controlling. *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.,* 447 U.S. 102, 118, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980). Second, Senator Hollings did not mention federal-court jurisdiction or otherwise suggest that 47 U.S.C. § 227(b)(3) is intended to divest federal courts of authority to hear TCPA claims. Hollings no doubt believed that mine-run TCPA claims would be pursued most expeditiously in state small-claims court. [14] But one cannot glean from his statement any expectation that those courts, or state courts generally, would have exclusive jurisdiction over private actions alleging violations of the Act or of the FCC's implementing regulations. Third, even if we agreed with Arrow that Senator Hollings expected private TCPA actions to proceed solely in state courts, and even if other supporters shared his view, that expectation would not control our judgment on 28 U.S.C. § 1331's compass. Cf. *Yellow Freight,* 494 U.S., at 826, 110 S.Ct. 1566 ("persuasive showing that most legislators, judges, and administrators ... involved in the enactment, amendment, enforcement, and interpretation of Title VII expected that such litigation would be processed exclusively in federal courts" did not overcome presumption of concurrent state-court jurisdiction).

Among its arguments for state-court exclusivity, Arrow raises a concern about the impact on federal courts were we to uphold ***753** § 1331 jurisdiction over private actions under the TCPA. "[G]iven the enormous volume of telecommunications presenting potential claims," Arrow projects, federal courts could be inundated by $500–per–violation TCPA claims. Brief for Respondent 33. "Moreover, if plaintiffs are free to bring TCPA claims in federal court under § 1331, then defendants sued in state court would be equally free to remove those cases to federal court under 28 U.S.C. § 1441." *Id.,* at 22–23. Indeed, Arrow suggests, defendants could use removal as a mechanism to force small-claims-court plaintiffs to abandon suit rather than "figh[t] it out" in the "more expensive federal forum." *Id.,* at 23.

[16] Arrow's floodgates argument assumes "a shocking degree of noncompliance" with the Act, Reply Brief 11, and seems to us more imaginary than real. The current federal district court civil filing fee is $350. 28 U.S.C. § 1914(a). How likely is it that a party would bring a $500 claim in, or remove a $500 claim to, federal court? Lexis and Westlaw searches turned up 65 TCPA claims removed to federal district courts in Illinois, Indiana, and Wisconsin since the Seventh Circuit held, in October 2005, that the Act does not confer exclusive jurisdiction on state courts. All 65 cases were class actions, not individual cases removed from small-claims court. [15] There were also 26 private TCPA claims brought initially in federal district courts; of those, 24 were class actions.

IV

Nothing in the text, structure, purpose, or legislative history of the TCPA calls for displacement of the federal-question jurisdiction U.S. district courts ordinarily have under 28 U.S.C. § 1331. In the absence of direction from Congress stronger than any Arrow has advanced, we apply the familiar default rule: Federal courts have § 1331 jurisdiction over claims that arise under federal law. Because federal law gives rise to the claim for relief Mims has stated and specifies the substantive rules of decision, the Eleventh Circuit erred in dismissing Mims's case for lack of subject-matter jurisdiction.

* * *

For the reasons stated, the judgment of the United States Court of Appeals for the Eleventh Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

All Citations

132 S.Ct. 740, 181 L.Ed.2d 881, 80 USLW 4116, 12 Cal. Daily Op. Serv. 704, 2012 Daily Journal D.A.R. 672, 55 Communications Reg. (P&F) 277, 23 Fla. L. Weekly Fed. S 95

Footnotes

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

[1] In general, the Communications Act of 1934 grants to the Federal Communications Commission (FCC or Commission) authority to regulate interstate telephone communications and reserves to the States authority to regulate intrastate telephone communications. See *Louisiana Pub. Serv. Comm'n v. FCC,* 476 U.S. 355, 360, 369–370, 106 S.Ct. 1890, 90 L.Ed.2d 369 (1986).

[2] In 2010, Congress amended the statute to prohibit an additional practice: the manipulation of caller-identification information. See Truth in Caller ID Act of 2009, Pub.L. 111–331, 124 Stat. 3572. This legislation inserted a new subsection (e) into 47 U.S.C. § 227 and redesignated the former subsections (e), (f), and (g) as subsections (f), (g), and (h), respectively. *Ibid.* While the new subsection (e) does not bear on this case and is not here discussed, our citations of subsection (g) refer to the current, redesignated statutory text.

[3] The National Do Not Call Registry is currently managed by the Federal Trade Commission. See 15 U.S.C. § 6151 (2006 ed., Supp. IV); 16 CFR § 310.4(b)(1)(iii) (2011).

[4] The TCPA envisions civil actions instituted by the Commission for violations of the implementing regulations. See 47 U.S.C.A. § 227(g)(7) (Supp.2011). The Commission may also seek forfeiture penalties for willful or repeated failure to comply with the Act or regulations. 47 U.S.C. § 503(b) (2006 ed. and Supp. IV), § 504(a) (2006 ed.).

[5] Title 47 U.S.C. § 227(c)(5), also captioned "Private right of action," provides:

> "A person who has received more than one telephone call within any 12–month period by or on behalf of the same entity in violation of the regulations prescribed under this subsection may, if otherwise permitted by the laws or rules of court of a State bring in an appropriate court of that State—
>
> "(A) an action based on a violation of the regulations prescribed under this subsection to enjoin such violation,
>
> "(B) an action to recover for actual monetary loss from such a violation, or to receive up to $500 in damages for each such violation, whichever is greater, or
>
> "(C) both such actions."

[6] Congress had previously granted general federal-question jurisdiction to federal courts, but the grant was short lived. See *Steffel v. Thompson,* 415 U.S. 452, 464, n. 14, 94 S.Ct. 1209, 39 L.Ed.2d 505 (1974) (describing Midnight Judges Act of 1801, § 11, 2 Stat. 92, repealed by Act of Mar. 8, 1802, § 1, 2 Stat. 132).

[7] At the time it was repealed, the amount-in-controversy requirement in federal-question cases had reached $10,000. See Act of July 25, 1958, 72 Stat. 415. Currently, the amount in controversy in diversity cases must exceed $75,000. See 28 U.S.C. § 1332.

[8] For a rare exception to the rule that a federal cause of action suffices to ground federal-question jurisdiction, see *Shoshone Mining Co. v. Rutter,* 177 U.S. 505, 20 S.Ct. 726, 44 L.Ed. 864 (1900), discussed in R. Fallon, J. Manning, D. Meltzer, & D. Shapiro, Hart and Wechsler's The Federal Courts and the Federal System, 784–785 (6th ed.2009). In *Shoshone Mining,* we held that a suit for a federal mining patent did not arise under federal law for jurisdictional purposes because "the right of possession" in controversy could be determined by "local rules or customs, or state statutes," 177 U.S., at 509, 20 S.Ct. 726, or "may present simply a question of fact," *id.,* at 510, 20 S.Ct. 726. Here, by contrast, the TCPA not only creates the claim for relief and designates the remedy; critically, the Act and regulations thereunder supply the governing substantive law.

[9] Even when a right of action is created by state law, if the claim requires resolution of significant issues of federal law, the case may arise under federal law for 28 U.S.C. § 1331 purposes. See *Grable & Sons Metal Products, Inc. v. Darue Engineering & Mfg.,* 545 U.S. 308, 312, 125 S.Ct. 2363, 162 L.Ed.2d 257 (2005).

[10] "How strange it would be," the Seventh Circuit observed, "to make federal courts the exclusive forum for suits by the states, while making state courts the exclusive forum for suits by private plaintiffs." *Brill v. Countrywide Home Loans, Inc.,* 427 F.3d 446, 451 (2005).

[11] For TCPA actions brought by State Attorneys General, or "an [other] official or agency designated by a State," 47 U.S.C.A. § 227(g)(1) (Supp.2011), Arrow points out, Congress specifically addressed venue, service of process, § 227(g)(4), and potential conflicts between federal and state enforcement efforts, § 227(g)(7). No similar prescriptions appear in the section on private actions, 47 U.S.C. § 227(b)(3), for this obvious reason:

> "[As] the general rules governing venue and service of process in the district courts are well established, *see* 28 U.S.C. § 1391(b); Fed. Rules Civ. Proc. 4, 4.1, there was no need for Congress to reiterate them in section 227(b)(3). The fact that venue and service of process are discussed in [47 U.S.C.A. § 227(g)(4) (Supp.2011)] and not [47 U.S.C. §]227(b)(3) simply indicates that Congress wished to make adjustments to the general rules in the former section and not the latter. As for the conflict provision that appears in section [47 U.S.C.A. § 227(g) (Supp.2011)] but not [47 U.S.C. §]227(b)(3), it is hardly surprising that Congress would be concerned about agency conflicts in the section of the TCPA dealing with official state enforcement efforts but not in the section governing private lawsuits." *ErieNet, Inc. v. Velocity Net, Inc.*, 156 F.3d 513, 523 (C.A.3 1998) (ALITO, J., dissenting).

12 The Supremacy Clause declares federal law the "supreme law of the land," and state courts must enforce it "in the absence of a valid excuse." *Howlett v. Rose,* 496 U.S. 356, 370, n. 16, 110 S.Ct. 2430, 110 L.Ed.2d 332 (1990). "An excuse that is inconsistent with or violates federal law is not a valid excuse: The Supremacy Clause forbids state courts to dissociate themselves from federal law because of disagreement with its content or a refusal to recognize the superior authority of its source." *Id.,* at 371, 110 S.Ct. 2430. Without the "if otherwise permitted" language, 47 U.S.C. § 227(b)(3), there is little doubt that state courts would be obliged to hear TCPA claims. See *Testa v. Katt,* 330 U.S. 386, 394, 67 S.Ct. 810, 91 L.Ed. 967 (1947).

13 Although all courts of appeals to have considered the question have held that the TCPA does not bar district courts from exercising diversity jurisdiction under 28 U.S.C. § 1332, see, *e.g., Gottlieb v. Carnival Corp.,* 436 F.3d 335 (C.A.2 2006), at oral argument, Arrow's counsel maintained that diversity jurisdiction "should go, too," Tr. of Oral Arg. 39. Were we to accept Arrow's positions that diversity and federal-question jurisdiction are unavailable, and that state courts may refuse to hear TCPA claims, residents of States that choose not to hear TCPA claims would have no forum in which to sue.

14 The complaint in this very case, we note, could not have been brought in small-claims court. Mims alleged some 12 calls, and sought treble damages ($1,500) for each. See App. 9–14; Tr. of Oral Arg. 12. The amount he sought to recover far exceeded the $5,000 ceiling on claims a Florida small-claims court can adjudicate. See Fla. Small Claims Rule 7.010(b) (rev. ed.2011).

15 When Congress wants to make federal claims instituted in state court nonremovable, it says just that. See *Breuer v. Jim's Concrete of Brevard, Inc.,* 538 U.S. 691, 696–697, 123 S.Ct. 1882, 155 L.Ed.2d 923 (2003) (quoting, *e.g.,* 28 U.S.C. § 1445(a) ("A civil action in any State court against a railroad or its receivers or trustees, [arising under §§ 51–60 of Title 45,] may not be removed to any district court of the United States.") and 15 U.S.C. § 77v(a) ("[N]o case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States.")).

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TAB 82

871 F.Supp.2d 933
United States District Court,
N.D. California.

MITSUI O.S.K. LINES, LTD., Plaintiff,
v.
SEAMASTER LOGISTICS, INC.; Toll Global Forwarding (Americas) Inc.; American Global Logistics LLC; Kesco Container Line, Inc.; Kesco Shipping, Inc.; and Does 1 through 20, Defendants.

No. 11–2861 SC.
|
May 10, 2012.

Synopsis
Background: Vessel operating common carrier (VOCC) which shipped freight between foreign and United States ports filed suit against non-vessel operating common carriers (NVOCC) alleging they had engaged in scheme to charge VOCC for unnecessary or nonexistent inland carriage of freight, in violation of Racketeer Influenced and Corrupt Organizations Act (RICO). Defendants moved to dismiss.

Holdings: The District Court, Samuel Conti, J., held that:

[1] complaint sufficiently alleged the enterprise element of RICO claim, and

[2] under nerve center test, alleged enterprise was domestic one, rather than foreign.

Motion denied.

Attorneys and Law Firms

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ORDER DENYING MOTIONS TO PARTIALLY DISMISS SECOND AMENDED COMPLAINT

SAMUEL CONTI, District Judge.

I. *INTRODUCTION*

Now before the Court are two motions to partially dismiss the Second Amended Complaint, ECF No. 72 (“SAC”), of Plaintiff Mitsui O.S.K. Lines, Ltd. (“MOL”), a Japanese corporation. Specifically, the motions seek dismissal of the SAC's fourth and fifth claims, arising under the Racketeer Influenced and Corrupt Organizations Act (“RICO”), 18 U.S.C. §§ 1962(c) and 1962(d). The first motion to dismiss was brought by Defendants Seamaster Logistics, Inc.

("Seamaster") and Toll Global Forwarding (Americas) Inc., formerly named Summit Logistics International, Inc. ("Summit"), and the second was brought by Defendant American Global Logistics LLC ("AGL") (collectively, "Moving Defendants").

Both motions are fully briefed. ECF Nos. 77 ("SM/SL MTD"), 78–1 ("AGL MTD"), 80 ("MOL Opp'n"), 82 ("SM/SL Reply"), 84 ("AGL Reply"). Pursuant to Civil Local Rule 7–1(b), both motions are suitable for decision without oral argument. For the reasons set forth below, the Court DENIES both motions.

II. *BACKGROUND*

The Court assumes familiarity with Magistrate Judge James's October 19, 2011, 2011 WL 4974476, Order dismissing MOL's original Complaint. ECF No. 38. Therefore, the Court will only briefly summarize the case, supplementing Judge James's account with allegations contained in the SAC. The Court recounts additional, specific allegations as part of the discussion sections below, and takes all of the SAC's well-pleaded allegations as true. *Ashcroft v. Iqbal,* 556 U.S. 662, 679, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009).

MOL is a Vessel Operating Common Carrier ("VOCC")—that is, an ocean shipper—operating between foreign and U.S. ports, including the Port of Oakland. Moving Defendants are, in industry parlance, "NVOCCs," that is, Non–Vessel Operating Common Carriers. Like MOL, they are shippers, but unlike MOL, they do not operate seafaring vessels. NVOCCs such as the Moving Defendants essentially are trucking companies that engage ***936** only in inland or "door" carriage, while VOCCs like MOL may engage in ocean shipping. *See* SAC ¶ 16.

Sometimes, in addition to providing ocean carriage, MOL is hired to arrange inland carriage. *See id.* On those jobs, called "through" or "door-to-door" carriage, MOL pays NVOCCs to arrange for the inland leg (or legs) of the trip on MOL's behalf. *Id.* MOL alleges that Defendants engaged in a scheme to charge MOL for unnecessary or nonexistent inland carriage. In essence, MOL alleges that Defendants routinely represented to MOL that they had performed inland carriage to or from a port serviced by MOL, but in actuality third parties would make the inland shipments. As a result, MOL allegedly was induced into paying for inland carriage that it never received. *See id.* ¶¶ 24–31. MOL alleges that some of this conduct occurred in inland China and some in the United States. *See* MOL Opp'n at 7–8 (identifying allegations of SAC which purportedly pertain to U.S. conduct).

The SAC's fourth and fifth claims assert that, by using postal mail, faxes, and the Internet to communicate with and bill MOL in connection with these shipments, Defendants engaged in wire and mail fraud—predicate acts that can support civil RICO liability under 18 U.S.C. §§ 1962(c) and (d), respectively. [1] *See* SAC ¶¶ 78–91. Moving Defendants' position, in brief, is that MOL cannot state viable RICO claims against them because the case primarily concerns conduct that took place in inland China and effected MOL in Japan, and that, under *Morrison v. National Australia Bank Ltd.,* ––– U.S. ––––, 130 S.Ct. 2869, 177 L.Ed.2d 535 (2010), RICO has no extraterritorial application.

III. *LEGAL STANDARD*

A motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) "tests the legal sufficiency of a claim." *Navarro v. Block,* 250 F.3d 729, 732 (9th Cir.2001). "Dismissal can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory." *Balistreri v. Pacifica Police Dep't,* 901 F.2d 696, 699 (9th Cir.1988). "When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief." *Iqbal,* 556 U.S. at 679, 129 S.Ct. 1937. However, "the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions. Threadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice." *Id.* (citing *Bell Atl. Corp. v. Twombly,* 550 U.S. 544, 555, 127 S.Ct. 1955, 167 L.Ed.2d 929 (2007)). The allegations made in a complaint must be both "sufficiently detailed to give fair notice to the opposing party of the nature of the claim so that the party may effectively defend against it" and "sufficiently plausible" such that "it is not unfair to require the opposing party to be subjected to the expense of discovery." *Starr v. Baca,* 633 F.3d 1191, 1204 (9th Cir.2011).

IV. *DISCUSSION*

A. Morrison *and Its Progeny*

Moving Defendants have not challenged the sufficiency of MOL's factual allegations. ***937** *See* SM/SL Reply at 7–8 (acknowledging that MOL's claims are sufficiently pled). Instead, Moving Defendants rest their challenge to MOL's RICO claims on *Morrison,* a securities action, and the handful of cases that have applied its reasoning in the RICO context. Because the post-*Morrison* RICO cases have yet to settle on a single approach, the Court will briefly survey the field. It concludes that *European Community v. RJR Nabisco, Inc.,* No. 02–CV–5771 (NGG)(VVP), 2011 WL 843957 (E.D.N.Y. Mar. 8, 2011), supplies the governing rule in this case.

1. Territoriality in the Securities Context

In *Morrison,* the Supreme Court considered whether § 10(b) of the Securities and Exchange Act of 1934 has extraterritorial application. 130 S.Ct. at 2876–77. The *Morrison* plaintiffs, all Australian nationals, had purchased stock in an Australian bank on an Australian stock exchange. Their complaint alleged that officers of the bank's U.S. subsidiary had, in the United States, made fraudulent statements that caused some of the subsidiary's assets to appear more valuable than they really were. *Id.* at 2876. On these facts, the Court addressed the question of whether the Australian plaintiffs had a viable cause of action under § 10(b), given the long-standing presumption against extraterritorial application of domestic laws. *Id.* at 2877–78.

The court held that they did not. Rejecting tests that various circuit courts had developed for ascertaining the extraterritorial application of statutes, *id.* at 2878–81, the court articulated the presumption against extraterritoriality in robust terms: "When a statute gives no clear indication of an extraterritorial application, it has none." *Id.* at 2878. The court then turned to the language of the Exchange Act, observing that "the objects of the statute's solicitude" were "transactions in securities listed on domestic exchanges, and domestic transactions in other securities ...." *Id.* at 2884. "It is those transactions that the statute seeks to regulate ...; it is parties or prospective parties to those transactions that the statute seeks to protect ...." *Id.* (citations omitted). On that basis, the court concluded that Congress did not intend for the Exchange Act to possess extraterritorial reach.

The *Morrison* court also rejected the argument that the case called only for *domestic* application of § 10(b). The court acknowledged that plaintiffs had alleged some U.S. conduct, but this did not make their proposed application of § 10(b) domestic rather than extraterritorial: "[I]t is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States. But the presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever *some* domestic activity is involved in the case." *Id.* (emphasis in original).

2. Cases Addressing Territoriality in the RICO Context

[1] Since *Morrison* made it clear that the presumption against extraterritoriality is a canon of construction applicable to any statute, *id.* at 2878–79, a half-dozen courts have applied its reasoning in the RICO context.[2] These courts have uniformly held that RICO is silent as to its extraterritorial application and that, under *Morrison,* it therefore has none. *See, e.g., In re* ***938** *Toyota,* 785 F.Supp.2d at 913; *Norex,* 631 F.3d at 32. Further, these courts have broadly agreed that, while the "object" of the Exchange Act's "solicitude" considered in *Morrison* was domestic securities transactions, in the RICO context "it is the 'enterprise' that is the object of the statute's solicitude, and the 'focus' of the statute." *European Cmty.,* 2011 WL 843957, at *5. Specifically, "the focus of RICO is on the enterprise as the recipient of, or cover for, a pattern of criminal activity." *Cedeño,* 733 F.Supp.2d at 474. RICO "seeks to regulate 'enterprises' by protecting them from being victimized by or conducted through racketeering activity." *European Cmty.,* 2011 WL 843957, at *5. [3]

Beyond these points, however, the cases' reasoning diverges. *Cf. In re Toyota,* 785 F.Supp.2d at 914–15 (surveying cases and observing that "[i]t is unclear how *Morrison*' s logic, which evaluates the 'focus' of the relevant statute, precisely translates to RICO"). This divergence has been obscured to a certain degree by factual differences between the cases, specifically, their varying mixtures of foreign and domestic elements. Some cases have been relatively clear-cut: Post-*Morrison* courts have had no difficulty concluding that far-flung foreign schemes conducted by foreign actors and implicating only incidental U.S. conduct are fundamentally extraterritorial and thus beyond the reach of RICO. [4] But in other cases, the balance of foreign and domestic elements has not been so one-sided. In those cases, district courts—starting from the premise that RICO has no extraterritorial application—have had to decide whether applying RICO to the facts before them would result in an impermissible extraterritorial application or a permissible domestic one. in *Morrison'* s memorable terms, these courts much or what kind of domestic conduct sends its kennel. *Morrison* does not say, and the approaches. [5]

The challenge of applying *Morrison* in RICO cases stems from the difficulty of ascertaining where a RICO enterprise is located. This difficulty was not present in the securities context from which *Morrison* ***939** arose. When the *Morrison* court determined that only "transactions in securities listed on domestic exchanges, and domestic transactions in other securities" were properly subject to the Exchange Act, 130 S.Ct. at 2884, it could rely on courts to identify the place where an alleged transaction occurred: Though securities transactions may occur in volume, each one occurs in a readily ascertained place at a readily ascertained time.

[2] RICO enterprises are different. They are not discrete events; they are groups of people. [6] As such, they do not "occur" in a place in the way that transactions do. They have an entirely different and, especially in the case of association-in-fact enterprises, more amorphous structure:

> [A]n association-in-fact enterprise is simply a continuing unit that functions with a common purpose. Such a group need not have a hierarchical structure or a "chain of command"; decisions may be made on an ad hoc basis and by any number of methods-by majority vote, consensus, a show of strength, etc. Members of the group need not have fixed roles; different members may perform different roles at different times. The group need not have a name, regular meetings, dues, established rules and regulations, disciplinary procedures, or induction or initiation ceremonies. *Boyle v. United States,* 556 U.S. 938, 948, 129 S.Ct. 2237, 173 L.Ed.2d 1265 (2009). An association-in-fact enterprise need only have "a purpose, relationships among those associated with the enterprise, and longevity sufficient to permit these associates to pursue the enterprise's purpose." *Id.* at 946, 129 S.Ct. 2237.

[3] Because the very notion of an association-in-fact enterprise is "expansive," *id.* at 944, 129 S.Ct. 2237, some alleged enterprises may be difficult to pin to a location. Nevertheless, because RICO applies only to domestic enterprises, courts will be called upon to determine whether a particular RICO enterprise, whatever its structure, is extraterritorial or domestic, which implies a rough determination of the location of the enterprise. The enterprise's location need not be targeted with pinpoint accuracy: The relevant question is simply whether the enterprise is extraterritorial or not. [7]

*940 3. The Nerve Center Test

The only case to squarely propose a principled way to determine the territoriality of a RICO enterprise is *European Community.* The *European Community* court recognized that "[b]ecause the 'focus' of RICO is the 'enterprise,' a RICO 'enterprise' must be a 'domestic enterprise.' " 2011 WL 843957, at *6 (citing *Morrison,* 130 S.Ct. at 2884). The court acknowledged the lack of precedent "suggesting how a court may determine the geographic location of a RICO enterprise." *Id.* It then analogized the inquiry to "determin[ing] the geographic location of a corporation." *Id.* The court turned for guidance to *Hertz Corp. v. Friend,* 559 U.S. 77, 130 S.Ct. 1181, 175 L.Ed.2d 1029 (2010). In that case, the Supreme Court set forth a "nerve center" test for ascertaining the state citizenship of a corporation for purposes of diversity jurisdiction. *Hertz,* 130 S.Ct. at 1192–94. The *European Community* court, applying *Hertz* principles, suggested that courts should focus on the RICO enterprise's "brains" as opposed to its "brawn," that is, on "the decisions effectuating the relationships and common interest of its members, and how those decisions are made," as compared to the location where the consequences of those decisions transpire. 2011 WL 843957, at *6. The court appeared to recognize that the inquiry will sometimes yield artificially simplified results, "i.e., [a] single place of business for a corporation, though there may be many," but stated that "the test is still instructive ...." *Id.*

[4] This Court agrees. The nerve center test provides a familiar, consistent, and administrable method for determining the territoriality of RICO enterprises in cases such as the one at bar, which blend domestic and foreign elements. It permits district courts deciding RICO cases like this one to analogize to the larger body of cases that use the nerve center test to identify a corporation's state court citizenship for diversity purposes. Further, the nerve center test has the virtue of recognizing that a RICO enterprise is analytically distinct from the pattern of predicate acts associated with it—a distinction that the earlier cases have sometimes blurred. *E.g., CGC Holding Co.,* 824 F.Supp.2d at 1209–10 (determining that RICO enterprise was domestic because the "racketeering activity of the enterprise ... was directed at and largely occurred within the United States"). In short, the test aligns the focus of the court's inquiry with the focus of RICO: "the enterprise as the recipient of, or cover for, a pattern of criminal activity." *Cedeño,* 733 F.Supp.2d at 474. To the extent that previous post-*Morrison* RICO cases—none of which are binding precedent on this Court—have focused on the nationality of a RICO enterprise's constituent members, the location of racketeering activity, the location of "effects," or the location or quantity of ambiguously defined "conduct," this Court parts ways with them.

B. *Application of Nerve Center Test*

The nerve center test ascertains the territoriality of an association-in-fact RICO enterprise by examining the alleged "decisions effectuating the relationships and common interest of [the enterprise's] members, and how those decisions are made." *European Cmty.,* 2011 WL 843957, at *6. This requires the Court first to examine the structure of the enterprise alleged by MOL.

1. Structure of the Alleged RICO Enterprise

"To state a claim under § 1962(c), a plaintiff must allege (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Odom v. Microsoft Corp.,* 486 F.3d 541, 547 (9th Cir.2007) (internal quotation marks omitted).[8] Presently, ***941** this Court is concerned only with the second element, that of the enterprise. Moving Defendants have not challenged the sufficiency of MOL's allegations of the "enterprise" element. Nevertheless, because MOL's pleading could be clearer in connecting its allegations to its claims, the Court recounts the allegations that comprise the enterprise element. The Court does so solely to illuminate the structure of the alleged enterprise, with an eye toward applying the nerve center test.

[5] "[A]n association-in-fact enterprise is simply a continuing unit that functions with a common purpose." *Boyle,* 556 U.S. at 948, 129 S.Ct. 2237. To plead the "enterprise" element of a RICO claim, plaintiffs must adequately allege that: (1) defendants have associated for a common purpose for engaging in a course of conduct, (2) in an ongoing organization, either formal or informal, and (3) the various associates function as a continuing unit. *See Odom,* 486 F.3d at 552–53.[9]

[6] The enterprise alleged by MOL satisfies these minimal structural requirements—which, as the Ninth Circuit has observed, are "not very demanding." *Id.* at 548. MOL alleges the following: Seamaster is a California corporation, Summit is a U.S. corporation with its principal place of business in New Jersey, and AGL is a "corporation and/or limited liability company" organized under Georgia law, with its principal place of business in that state. SAC ¶¶ 4–5, 10. Both Summit and Seamaster are part of a group of companies whose corporate parent is the Toll Group ("Toll"), a business entity of form unknown. *Id.* ¶ 6 & n. 1.[10] During a period covering 2006–2007, Summit and Seamaster were spun off from a corporate forebearer, the Hecny Group ("Hecny"), with whom Summit and Seamaster now directly compete. *Id.* ¶ 7. Jerry Huang, aka Huang Chun Jen ("Huang"), was a "key executive and member of the Board of Directors" of Hecny, *id.,* and now is Summit's Managing Director for the Asia Pacific Region, *id.* ¶ 8.

Hecny was the "longtime strategic partner" of a company called Global Link Logistics, Inc. ("Global Link"), whose founder and CEO was Chad Rosenberg ("Rosenberg"). *Id.* ¶ 12. Rosenberg left Global Link and bought Moving Defendant AGL; Rosenberg now serves as AGL's CEO. *Id.* ¶¶ 11–12, 14; Ex. I.

MOL alleges that the relationship between AGL on the one hand and Summit and Seamaster on the other is a "strategic partnership" mirroring that of Hecny and Global Link. *Id.* ¶ 15. Furthermore, MOL avers that Summit/Seamaster and AGL comprise an association-in-fact. *Id.* "Through Seamaster, AGL ships goods with MOL on behalf of customers in the United States who are the ultimate recipient ***942** of the goods." *Id.* The purpose of the relationship is "to facilitate the import transportation of cargo (largely furniture and other consumer goods) from Asia to the United States." *Id.* MOL alleges that Summit, Seamaster, and AGL "actively conducted and participated in the affairs of the enterprise" by "arranging for and otherwise participating in thousands of shipments of cargo from Asia to the United States." *Id.* ¶ 80. MOL alleges that the partnership and related shipping activities began at least in 2007 and continued until at least 2011. *Id.* ¶ 79.

[7] Taken together, these allegations describe an association-in-fact enterprise, that is, "a continuing unit that functions with a common purpose" without being, itself, a legal entity. *Boyle,* 556 U.S. at 948, 129 S.Ct. 2237; 18 U.S.C. § 1961(4). MOL alleges a common purpose, namely, the import transportation of cargo from Asia to the United States. MOL further alleges an ongoing organization. An ongoing organization is nothing more than "a vehicle for the commission of two or more predicate crimes" which need not have any particular formal organization. *See Odom,* 486 F.3d at 552. MOL alleges that Seamaster/Summit and AGL form a strategic partnership which engages in the allegedly wrongful shipping practices described in the SAC, practices which are furthered by the alleged mail and wire frauds. While MOL does not allege that the partners are bound by any formal agreement or structure, they are not required to do so. *See id.* Further, the presence of Huang and Rosenberg in both the previous Hecny/Global Link partnership and the current alleged partnership between Seamaster, Summit, and AGL supports a reasonable inference that these corporations serve, at least to a significant degree, to effectuate the purposes of an informal alliance of businesspeople. Lastly, MOL's allegations describe an enterprise that satisfies the continuity requirement. This requirement "focuses on whether the associates' behavior was 'ongoing' rather than isolated activity." *Odom,* 486 F.3d at 553 (quoting *United States v. Patrick,* 248 F.3d 11, 19 (1st Cir.2001)). MOL's allegation that the partnership, as well as the shipping activities at the center of this case, were ongoing at least from 2007 to 2011 easily satisfies this standard.

2. Territoriality of the Alleged RICO Enterprise

[8] Having described the alleged RICO enterprise, the Court now applies the nerve center test to determine whether RICO applies to it. This test examines the "decisions effectuating the relationships and common interest of [the enterprise's] members, and how those decisions are made." *European Cmty.,* 2011 WL 843957, at *6. Focusing on the brains rather than the brawns of the enterprise, *id.,* the Court concludes that the enterprise alleged here is a domestic one.

The Court first observes that all three Moving Defendants are U.S. corporations. Their domestic legal status is not by itself dispositive. *See supra* pp. 940–41 (rejecting notion that "nationality of a RICO enterprise's constituent members" determines territoriality). Their domestic status tends to show, however, that the decision making necessary to effectuate the alleged association-in-fact enterprise's common purpose occurred substantially within the territory of the United States.

Additionally, MOL alleges that Seamaster, Summit, and AGL "arranged" shipments in the United States. The location where the shipping actually took place is merely evidence of where the enterprise exercised its "brawn." It is the activity of arranging the allegedly illicit shipments that indicates where the enterprise exercised its "brains." MOL alleges that these ***943** shipments were arranged in substantial part within the United States, which, in combination with the U.S. status of the alleged enterprise's member corporations, supports a reasonable inference in MOL's favor, i.e., that the enterprise's nerve center was domestic.

Even if the Court were to read the allegations of the complaint in a light less favorable to MOL—and in the procedural posture of this case, the Court must do the opposite—MOL has alleged, at minimum, an enterprise with one foot in China and one in the United States. This is more than the merely incidental domestic activity which, *Morrison* warned, would do nothing to shake the watchdog from its post. *See Morrison,* 130 S.Ct. at 2884. On the contrary, MOL alleges a cross-national enterprise that uses U.S. corporations as cover for a pattern of racketeering activities. These allegations are enough to assert the existence of a domestic enterprise to whose activities RICO applies. *See Cedeño,* 733 F.Supp.2d at 474.

Moving Defendants' arguments to the contrary are unavailing. Apparently following the "conduct" approach that some earlier cases took, but which this Court has declined to follow, *see supra* Section IV.A.3, AGL characterizes this case as being "primarily" or "at its core" about conduct in inland China. AGL MTD at 2, AGL Reply at 4. AGL argues, in essence, that because the bulk of the allegations in the SAC relate to conduct in China, the alleged RICO enterprise must be extraterritorial. As MOL points out, AGL essentially ignores MOL's allegations of U.S. conduct. But even if AGL had accurately characterized MOL's allegations, the location of "conduct" is simply not the test. The location of the enterprise is. AGL's position would supplant the relatively principled nerve center test with one that invites courts to adopt a "know-it-when-they-see-it" approach to territoriality, with predictably unpredictable results. This Court declines to adopt that approach.

For their part, Seamaster and Summit urge the Court to dismiss MOL's RICO claims because MOL alleges "an international, not domestic, RICO enterprise." SM/SL Reply at 4. This argument misapprehends the holding of *Morrison.* That case teaches that *"some* domestic activity" will not save an otherwise extraterritorial RICO claim—not that *any* international activity will doom an otherwise domestic claim. *See Morrison,* 130 S.Ct. at 2884 (emphasis in original). Essentially, Seamaster and Summit argue that even though MOL alleges an enterprise with domestic ties substantial enough to make it at least "international," such an enterprise is not truly domestic because the extraterritorial elements somehow matter more. Adopting this position would require the Court to engage in the sort of conduct-weighing analysis that it has already declined to undertake. When a RICO plaintiff alleges a combination of domestic and foreign elements (e.g., conduct, effects, actors), a court needs some way to determine whether the domestic elements outweigh the foreign for purposes of the territoriality inquiry. This implies a determination about which elements are relatively important. Such a determination could be made on an ad hoc basis after examining the (often prolix and complex) allegations of the RICO complaint. But this Court believes that the analysis calls instead for a consistent method that cuts through extraneous matter to the heart of the issue. The nerve center test meets this need. In the RICO context, as well as in the corporate citizenship context from which it is derived, the nerve center test takes a sprawling network of decision makers and actors and reduces it, for legal purposes, to a single, simplified location. This simplification is a feature, not a bug. Seamaster and Summit's position would unhelpfully ***944** muddy the analysis: Whereas the relevant categories under *Morrison* are "extraterritorial" and "not," Seamaster and Summit would add a third category—"both." In such situations, courts would be stuck making ad hoc determinations about territoriality without a reliable guide.

The Court also rejects Seamaster and Summit's argument that MOL's RICO claims are impermissibly extraterritorial because MOL, as a Japanese company, feels the effects of the alleged scheme in Asia. SM/SL Reply at 4. *Morrison* repudiated the "effects" tests adopted by various circuits and replaced it with one that focuses, in the securities context, on the location of the alleged transaction, and, in the RICO context, on the location of RICO's object of solicitude, the enterprise as a cover for or victim of racketeering activity. *Cedeño,* 733 F.Supp.2d at 474. *Morrison*' s holding bars courts from refusing to apply RICO simply because the scheme's effects are felt abroad; it does not suggest that courts may *deny* relief for that reason. It is true that "MOL unambiguously seeks application of RICO to remedy harmful effects felt outside the United States." SM/SL Reply at 4. Such application is entirely permissible under *Morrison,* because the enterprise causing those foreign effects is a domestic one.

V. *CONCLUSION*

Moving Defendants have not challenged MOL's RICO claims on any grounds other than the presumption against extraterritoriality. Having concluded for the foregoing reasons that this challenge does not succeed, the Court accordingly DENIES the partial motions to dismiss brought, respectively, by Defendants Seamaster Logistics, Inc., and Toll Global Forwarding (Americas) Inc., formerly named Summit Logistics International, Inc., and by American Global Logistics LLC. Plaintiff Mitsui O.S.K. Lines, Ltd.'s RICO claims remain undisturbed, as do the other, unchallenged claims of the Second Amended Complaint.

IT IS SO ORDERED.

All Citations

871 F.Supp.2d 933, Fed. Sec. L. Rep. P 96,826, RICO Bus.Disp.Guide 12,209

Footnotes

[1] Section 1962(c) provides: "It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt." Section 1962(d) makes it unlawful to conspire to do so. Section 1961(1) enumerates prohibited racketeering activities (or "predicate acts"), which include mail and wire fraud.

[2] *Cedeño v. Intech Group, Inc.,* 733 F.Supp.2d 471, 474 (S.D.N.Y.2010); *Norex Petroleum Ltd. v. Access Industries, Inc.,* 631 F.3d 29, 32 (2d Cir.2010); *European Cmty.,* 2011 WL 843957; *United States v. Philip Morris USA, Inc.,* 783 F.Supp.2d 23, 28–29 (D.D.C.2011); *In re Toyota Motor Corp.,* 785 F.Supp.2d 883, 913 (C.D.Cal.2011); *CGC Holding Co., LLC v. Hutchens,* 824 F.Supp.2d 1193, 1209–10 (D.Colo.2011).

[3] *See also Philip Morris,* 783 F.Supp.2d at 28–29 (citing *Cedeño,* 733 F.Supp.2d at 473) (RICO "is focused on how a pattern of racketeering activity affects an enterprise"); *In re Toyota,* 785 F.Supp.2d at 914 (same); *but see CGC Holding Co.,* 824 F.Supp.2d at 1209–10 ("The focus of [RICO] is the racketeering activity, i.e., to render unlawful a pattern of domestic racketeering activity perpetrated by an enterprise.").

[4] *See Cedeño,* 733 F.Supp.2d 471 (Venezuelan actors allegedly conspired to imprison Venezuelan national in Venezuela); *Norex,* 631 F.3d 29 (conspiracy by Russian nationals to seize control over Russian oil industry through widespread bribery and institutional corruption in Russia); *European Cmty.,* 2011 WL 843957 (South American and Russian cartels allegedly operated labyrinthine international money laundering and smuggling scheme involving illicit distribution abroad of U.S.-made cigarettes).

[5] *See Philip Morris,* 783 F.Supp.2d 23 (where English cigarette manufacturer allegedly conspired to deceive American public about health effects of smoking, district court dismissed RICO claims, despite enterprise's "tremendous impacts" on United States, because English defendant's domestic conduct was "isolated" and not by itself actionable under RICO); *In re Toyota,* 785 F.Supp.2d at 914–15 (dismissing RICO claims as insufficiently pled but observing that well-pled allegations of "enterprise operating in the United States, consisting largely of domestic 'persons,' engaging in a pattern of racketeering activity in the

United States, and damaging Plaintiffs abroad, ... might well state a claim consistent with *Morrison's* holding"); *CGC Holding Co.,* 824 F.Supp.2d at 1209–10 (where Canadian nationals allegedly engaged in an enterprise "to extract money from [U.S. plaintiffs] through a phony loan scheme," plaintiffs stated cognizable RICO claim because "the racketeering activity of the enterprise ... was directed at and largely occurred within the United States").

6 RICO defines the term "enterprise" to include "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4). The latter type of enterprise—the kind that is not a legal entity—is commonly called an "association-in-fact" or "associated-in-fact" enterprise. *E.g., Cedeño,* 733 F.Supp.2d at 472; *In re Toyota,* 785 F.Supp.2d at 900.

7 The location of the associated racketeering activity is a different question, and not dispositive of the issue of the enterprise's territoriality. "The 'enterprise' is not the 'pattern of racketeering activity'; it is an entity separate and apart from the pattern of activity in which it engages." *United States v. Turkette,* 452 U.S. 576, 583, 101 S.Ct. 2524, 69 L.Ed.2d 246 (1981). "RICO is not a recidivist statute designed to punish someone for committing a pattern of multiple criminal acts. Rather, it prohibits the use of such a pattern to impact an enterprise ...." *Cedeño,* 733 F.Supp.2d at 473. Accordingly, the question before this Court is not where the predicate acts alleged by MOL took place, but rather the territoriality of the alleged enterprise itself. *See id.* at 474; *European Cmty.,* 2011 WL 843957, at *5. The propriety of focusing the territoriality inquiry on the enterprise rather than the racketeering is confirmed by the fact that RICO defines the term "enterprise" to include legal entities. 18 U.S.C. § 1961(4). In such cases, the territoriality of the RICO enterprise clearly would not depend on the location where predicate acts occurred but on the location of the legal entity, that is, of the enterprise itself. The Court sees no reason why the analysis should differ for association-in-fact enterprises.

8 MOL also asserts a claim under subsection (d) of § 1962. Subsection (d) simply makes it unlawful to conspire to violate the preceding three subsections. Since Moving Defendants' § 1962(d) liability depends on MOL making out a viable claim under § 1962(c), and Moving Defendants have raised no specific challenge to the conspiracy element of MOL's § 1962(d) claim, the Court focuses on § 1962(c) exclusively.

9 *Odom* was decided before *Boyle,* but the Court sees no distinction between the cases' respective definitions of a RICO enterprise. Both cases simply applied the holding of *Turkette* to reject argument that RICO required a plaintiff to show that an enterprise has a separate or "ascertainable" structure, i.e., one going beyond what is necessary to carry out its racketeering activities. *Compare Odom,* 486 F.3d at 553 *with Boyle,* 556 U.S. at 948, 129 S.Ct. 2237. The Court therefore continues to recognize *Odom* as binding authority.

10 As explained *supra* in the Introduction, Summit is Toll's former name and Toll appears in this action as Toll Global Forwarding (Americas) Inc.

End of Document

TAB 83

104 S.Ct. 2709
Supreme Court of the United States

PENSION BENEFIT GUARANTY CORPORATION
v.
R.A. GRAY & COMPANY.
OREGON–WASHINGTON CARPENTERS–EMPLOYERS PENSION TRUST FUND
v.
R.A. GRAY & COMPANY.

Nos. 83-245, 83-291.
|
Argued April 16, 1984.
|
Decided June 18, 1984.

The United States District Court for the District of Oregon, 549 F.Supp. 531, held that the Multiemployer Pension Plan Amendments Act was constitutional. The Court of Appeals, 705 F.2d 1502, reversed, and probable jurisdiction was noted, 104 S.Ct. 271. The Supreme Court, Justice Brennan, held that in view of congressional purpose in utilizing retroactive application of the statutes, i.e., to prevent employers from taking advantage of lengthy legislative process and withdrawing while Congress debated revisions, application of the withdrawal liability provisions to employers withdrawing from pension plans during the five-month period prior to the statute's enactment did not violate due process clause of the Fifth Amendment, such purpose being a rational legislative purpose.

Judgment of Court of Appeals reversed, and cases remanded.

Syllabus[a1]

The Employee Retirement Income Security Act (ERISA), enacted in 1974, created a pension plan termination insurance program whereby the Pension Benefit Guaranty Corporation (PBGC), a wholly owned Government corporation, collects insurance premiums from covered private retirement pension plans and provides benefits to participants if their plan terminates with insufficient assets to support its guaranteed benefits. For multiemployer pension plans, the PBGC's payment of guaranteed benefits was not to become mandatory until January 1, 1978. During the intervening period, the PBGC had discretionary authority to pay benefits upon the termination of such plans. If the PBGC exercised its discretion to pay such benefits, employers who had contributed to the plan during the five years preceding its termination were liable to PBGC in amounts proportional to their share of the plan's contributions during that period. As the mandatory coverage date approached, Congress became concerned that a significant number of multiemployer pension plans were experiencing extreme financial hardship that would result in termination of numerous plans, forcing the PBGC to assume obligations in excess of its capacity. Ultimately, after deferring the mandatory coverage until August 1, 1980, and extensively debating the issue of withdrawal liability in 1979 and 1980, Congress enacted the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), requiring an employer withdrawing from a multiemployer **2712 pension plan to pay a fixed and certain debt to the plan amounting to the employer's proportionate share of the plan's "unfunded vested benefits." These withdrawal liability provisions were made to take effect approximately five months before the statute was enacted into law. When appellee building and construction firm, within this 5–month period, withdrew from a multiemployer pension plan that it had been contributing to under collective-bargaining agreements with a labor union, the pension plan notified appellee that it had incurred a withdrawal liability and demanded *718 payment. Appellee then filed suit in Federal District Court, seeking declaratory and injunctive relief against the pension plan and the PBGC and claiming, inter alia, that the retroactive application of the MPPAA violated the Due Process Clause of the Fifth Amendment. The District Court rejected this claim and granted summary judgment in favor of the pension plan and the PBGC. The Court of Appeals reversed, holding that retroactive application of withdrawal liability violated the Due Process Clause because employers had reasonably relied on the contingent withdrawal liability provisions included in ERISA prior to passage of the MPPAA and because the equities generally favored appellee over the pension plan.

Held: Application of the withdrawal liability provisions of the MPPAA during the 5–month period prior to the statute's enactment does not violate the Due Process Clause of the Fifth Amendment. Pp. 2717–2720.

(a) The burden of showing that retroactive legislation complies with due process is met by showing that retroactive application of the legislation is justified by a rational legislative purpose. Here, it was rational for Congress to conclude that the MPPAA's purposes could be more fully effectuated if its withdrawal liability provisions were applied retroactively. One of the primary problems that Congress identified under ERISA was that the statute encouraged employer withdrawals from multiemployer pension plans, and Congress was properly concerned that employers would have an even greater incentive to withdraw if they knew that legislation to impose more burdensome liability on withdrawing employers was being considered. Congress therefore utilized retroactive application of the statute to prevent employers from taking advantage of the lengthy legislative process and withdrawing while Congress debated necessary revisions in the statute. Pp. 2717–2719.

(b) It is doubtful that retroactive application of the MPPAA would be invalid under the Due Process Clause even if it was suddenly enacted without any period of deliberate consideration. But even assuming that advance notice of retroactive legislation is constitutionally compelled, employers had ample notice of the withdrawal liability imposed by the MPPAA. Not only did ERISA impose contingent liability, but the various legislative proposals debated by Congress before the MPPAA was enacted uniformly included retroactive effective dates. P. 2719.

(c) The principles embodied in the Fifth Amendment's Due Process Clause have never been held coextensive with prohibitions existing against state impairments of pre-existing contracts. Rather, the limitations imposed on States by the Contract Clause have been contrasted with the less searching standards imposed on economic legislation by the Due Process Clauses. Pp. 2719–2720.

***719** (d) Unlike the statute invalidated in Railroad Retirement Board v. Alton R. Co., 295 U.S. 330, 55 S.Ct. 758, 79 L.Ed. 1468, which required employers to finance pensions for former employees who had already been fully compensated while employed, the MPPAA merely requires a withdrawing employer to compensate a pension plan for benefits that have already vested with the employees at the time of the employer's withdrawal. P. 2720.

705 F.2d 1502, reversed and remanded.

Attorneys and Law Firms

Baruch A. Fellner argued the cause for appellants in both cases. With him on the briefs for appellant in No. 83-245 were *Henry Rose, Mitchell L. Strickler, J. Stephen Caflisch, Peter H. Gould, David F. Power, Nathan Lewin,* and *Seth P. Waxman. William B. Crow, James N. Westwood, William H. Walters,* and *David S. Paull* filed briefs for appellant in No. 83-291.

****2713** *Thomas M. Triplett* argued the cause and filed a brief for appellee.†>>>>

† *Gerald M. Feder* filed a brief for the National Coordinating Committee for Multiemployer Plans as *amicus curiae* urging reversal.

Briefs of *amici curiae* urging affirmance were filed for G & R Roofing Co. by *Michael E. Merrill, Stephen J. Schultz,* and *Mark T. Bennett;* for the National Association of Wholesaler-Distributors by *Harold T. Half-penny;* for the National Association of Manufacturers by *Chester W. Nosal, John R. Keys, Jr., Jan S. Amundson,* and *Quentin Riegel;* for the National-American Wholesale Grocers' Association by *William H. Borghesani, Jr.,* and *Peter A. Susser;* for the National Steel Service Center, Inc., by *Ralph T. DeStefano* and *Richard R. Riese;* for Republic Industries, Inc., by *Philip B. Kurland, Christopher G. Walsh, Jr., Lester M. Bridgeman,* and *Louis T. Urbanczyk;* for Sibley, Lindsay & Curr Co. by *William L. Dorr;* and for Transport Motor Express, Inc., et al. by *Harris Weinstein.*

Jack L. Whitacre and *Stephen A. Bokat* filed a brief for the Chamber of Commerce of the United States as *amicus curiae.*

Opinion

Justice BRENNAN delivered the opinion of the Court.

The question presented by these cases is whether application of the withdrawal liability provisions of the Multiemployer ***720** Pension Plan Amendments Act of 1980 to employers withdrawing from pension plans during a 5–month period prior to the statute's enactment violates the Due Process Clause of the Fifth Amendment. We hold that it does not.

I

A

[1] In 1974, after careful study of private retirement pension plans, Congress enacted the Employee Retirement Income Security Act (ERISA), 88 Stat. 829, 29 U.S.C. § 1001 et seq. Among the principal purposes of this "comprehensive and reticulated statute" was to ensure that employees and their beneficiaries would not be deprived of anticipated retirement benefits by the termination of pension plans before sufficient funds have been accumulated in the plans. Nachman Corp. v. Pension Benefit Guaranty Corp., 446 U.S. 359, 361–362, 374–375, 100 S.Ct. 1723, 1726, 1732–1733, 64 L.Ed.2d 354 (1980). See Alessi v. Raybestos–Manhattan, Inc., 451 U.S. 504, 510–511, 101 S.Ct. 1895, 1899–1900, 68 L.Ed.2d 402 (1981). Congress wanted to guarantee that "if a worker has been promised a defined pension benefit upon retirement—and if he has fulfilled whatever conditions are required to obtain a vested benefit—he actually will receive it." Nachman, supra, 446 U.S., at 375, 100 S.Ct., at 1733; Alessi, supra, 451 U.S., at 510, 101 S.Ct., at 1899.

Toward this end, Title IV of ERISA, 29 U.S.C. § 1301 et seq., created a plan termination insurance program, administered by the Pension Benefit Guaranty Corporation (PBGC), a wholly owned Government corporation within the Department of Labor, § 1302. The PBGC collects insurance premiums from covered pension plans and provides benefits to participants in those plans if their plan terminates with insufficient assets to support its guaranteed benefits. See §§ 1322, 1361. For pension plans maintained by single employers, the PBGC's obligation to pay benefits took effect immediately upon enactment of ERISA in 1974. §§ 1381(a)–(b). For multiemployer pension plans, however, the payment of guaranteed benefits by the PBGC was not to become mandatory until January 1, 1978. § 1381(c)(1).

***721** During the intervening period, the PBGC had discretionary authority to pay benefits upon the termination of multiemployer pension plans. §§ 1381(c)(2)–(4). If the PBGC exercised its discretion to pay such benefits, employers who had contributed to the plan during the five years preceding its termination were liable to the PBGC in amounts proportional to their share of the plan's contributions during that period. § 1364. In other words, any employer withdrawing from a multiemployer plan was subject to a contingent liability that was dependent upon the plan's termination in the next five years and the PBGC's decision to exercise its discretion and pay guaranteed benefits. In addition, any individual employer's liability was not to exceed 30% of the employer's net worth. § 1362(b)(2).

As the date for mandatory coverage of multiemployer pension plans approached, Congress became concerned that a significant number of plans were experiencing extreme financial hardship. This, in turn, could have resulted in the termination of numerous plans, forcing the PBGC to assume obligations in excess of its capacity. To avoid this potential collapse of the plan termination insurance program, Congress deferred mandatory insurance coverage for multiemployer plans for 18 months—until July 1, 1979—extending the PGBC's discretionary authority to insure plans terminating during the interim. ****2714** Pub.L. 95–214, 91 Stat. 1501. [1] The PBGC was also directed to prepare a comprehensive report analyzing the problems faced by multiemployer plans and recommending appropriate legislative action. See S.Rep. No. 95–570, pp. 1–4 (1977), U.S.Code Cong. & Admin.News 1977, p. 4128; ***722** H.R.Rep. No. 95–706, p. 1 (1977). In this way, Congress created "time to legislate, if necessary, before the mandatory coverage comes into effect." 123 Cong.Rec. 36800 (1977) (statement of Sen. Williams); id., at 36800–36802.

The PBGC issued its report on July 1, 1978. Pension Benefit Guaranty Corporation, Multiemployer Study Required by P.L. 95–214 (1978). Among its principal findings was that ERISA did not adequately protect plans from the adverse consequences that resulted when individual employers terminate their participation in, or withdraw from, multiemployer plans. As the report summarized:

"The basic problem with the withdrawal rules is that they are designed primarily to protect PBGC. They do not provide an efficient mechanism for reducing the burden of withdrawal on the plan and remaining employers. They may even encourage withdrawals in some instances (e.g., where termination may be imminent). Changes in the withdrawal rules should be considered:

"(1) to provide relief to plans without increasing the burden on the insurance system,

"(2) to provide a disincentive to voluntary employer withdrawals,

"(3) to reduce or remove disincentives to plan entry, and

"(4) to work with, instead of against, the termination liability provisions." Id., at 96–97. [2]

[2] ***723** To alleviate the problem of employer withdrawals, the PBGC suggested new rules under which a withdrawing employer would be required to pay whatever share of the plan's unfunded vested liabilities was attributable to that employer's participation. Id., at 97–114. [3] These tentative proposals were included in policy recommendations submitted to Congress on February 27, 1979, and were incorporated in proposed legislation that the Executive ****2715** Branch formally sent to Congress three months later, S.1076, 96th Cong., 1st Sess. (1979). Most significantly for present purposes, the bill included an effective date for withdrawal liability of February 27, 1979—the date on which the PBGC had initially submitted its recommendations to Congress. Id., § 108. This date was chosen to prevent employers from avoiding the adverse consequences of withdrawal liability by withdrawing from plans while such liability was being considered by Congress. As one Senator noted, the retroactive effective date was designed "to prevent ... the withdrawal of these opportunistic employers without imposition of liability" and was to ***724** serve "as a deterrent to hasty employer withdrawal." 126 Cong.Rec. 20234 (1980) (remarks of Sen. Matsunaga).

Congress debated the issue of withdrawal liability for the remainder of 1979 and much of 1980. By April 1980, two Committees in the House and one in the Senate had approved substantially similar versions of the bill, each containing the February 27, 1979, effective date for withdrawal liability. The Senate Finance Committee had not yet completed its work on the bill, however, and sought more time for consideration of the legislation. See supra, at 3, and n. 1. At the same time, the Senate advanced the effective date for imposing withdrawal liability to April 29, 1980. As Senator Javits later explained:

"The committees decided in part to move up the date from February 27, 1979, the date contained in earlier versions of the bill, because the original purpose of a retroactive effective date—namely, to avoid encouragement of employer withdrawals while the bill was being considered—has been achieved. It should also be noted that the April 29 effective date is the product of strong political pressures by certain withdrawing employers who were caught by the earlier date. I realize that permitting these employers to avoid liability only increases the burdens of those employers remaining with the plans in question, but it appears necessary to accept the April 29 date in order to enact the bill before the August 1 deadline for action." 126 Cong.Rec. 20179 (1980) (statement of Sen. Javits).

See also id., at 9236–9237 (statement of Sen. Bentsen).

The House unanimously passed its version of the bill, including the February 27, 1979, effective date, in May 1980. Id., at 12233. The Senate version, adopting an effective date of April 29, 1980, was endorsed by a vote of 85–1. Id., at 20247. The Conference Committee accepted the Senate's effective date, and the legislation was signed into law by ***725** the President on September 26, 1980. Multiemployer Pension Plan Amendments Act of 1980 (MPPAA or Act), Pub.L. 96–364, 94 Stat. 1208. As enacted, the Act requires that an employer withdrawing from a multiemployer pension plan pay a fixed and certain debt to the pension plan. This withdrawal liability is the employer's proportionate share of the plan's "unfunded vested benefits," calculated as the difference between the present value of vested benefits and the current value of the plan's assets. 29 U.S.C. §§ 1381, 1391. Pursuant to 29 U.S.C. § 1461(e), these withdrawal liability provisions took effect on April 29, 1980, approximately five months before the statute was enacted into law.

B

Appellee R.A. Gray & Co. (Gray) is a building and construction firm doing business in Oregon. Under a series of collective-bargaining agreements with the Oregon State Council of Carpenters (Council), Gray contributed to the Oregon–Washington Carpenters–Employers Pension Trust Fund (Pension Plan), a multiemployer pension plan under 29 U.S.C. § 1301(a)(3). During February 1980, Gray advised the Council that it would be terminating their collective-bargaining agreement when it expired on June 1, 1980. Gray continued to engage in the building and construction industry, however, and therefore was deemed to have completely ****2716** withdrawn from the Pension Plan pursuant to § 1383(b).

[3] The Pension Plan subsequently notified Gray that, by completely withdrawing from the plan on June 1, 1980, it had incurred a withdrawal liability of $201,359. The notice set forth a schedule of quarterly payments and demanded payment in accordance with that schedule. After some preliminary correspondence between Gray and the plan's trustees, the Pension Plan informed Gray that it was delinquent in its payments. Gray thereafter filed suit in the United States District Court for the District of Oregon, seeking ***726** declaratory and injunctive relief against the Pension Plan and the PBGC.[4]

Gray's complaint raised several constitutional claims, including a challenge to the retroactive application of the MPPAA under the Due Process Clause of the Fifth Amendment.[5] In particular, Gray noted that its June 1, 1980, withdrawal from the Pension Plan occurred during the 5–month period preceding enactment of the MPPAA, and therefore was directly affected by the retroactivity provision included in the Act. Moreover, Gray contended, retroactive application of withdrawal liability could not be sustained under the Due Process Clause because it was arbitrary and irrational, and because it impaired the collective-bargaining agreements that Gray had signed with the Council.

***727** The District Court rejected Gray's due process claim, and granted summary judgment in favor of the Pension Plan and the PBGC. 549 F.Supp. 531 (1982). Specifically, the court analyzed the constitutionality of retroactively imposing withdrawal liability on employers by applying a four-part test established by the Court of Appeals for the Seventh Circuit in Nachman Corp. v. Pension Benefit Guaranty Corp., 592 F.2d 947 (1979), aff'd on statutory grounds, 446 U.S. 359, 100 S.Ct. 1723, 64 L.Ed.2d 354 (1980). As that test requires, the court examined (1) the reliance interest of the affected parties, (2) whether the interest impaired is in an area previously subjected to regulatory control, (3) the equities of imposing the legislative burdens, and (4) the statutory provisions that limit and moderate the impact of the burdens imposed.[6] ****2717** Under these criteria, the court concluded that Gray had not satisfied the heavy burden faced by parties attempting to demonstrate that Congress has acted arbitrarily and irrationally when enacting socioeconomic legislation.

The Court of Appeals for the Ninth Circuit reversed, although it too believed that the four-factor Nachman test was the appropriate standard to use when analyzing the constitutionality of retroactive legislation enacted by Congress. ***728** Shelter Framing Corp. v. Pension Benefit Guaranty Corp., 705 F.2d 1502 (1983). In particular, the court concluded that retroactive application of withdrawal liability violated the Due Process Clause because employers had reasonably relied on the contingent withdrawal liability provisions included in ERISA prior to passage of the MPPAA, id., at 1511–1512, and because the equities in this action generally favored Gray over the Pension Plan, id., at 1512–1514.

Both the Pension Plan and the PBGC invoked the appellate jurisdiction of this Court under 28 U.S.C. § 1252. We noted probable jurisdiction, 464 U.S. 912, 104 S.Ct. 271, 78 L.Ed.2d 253 (1983),[7] and now reverse.

II

[4] The starting point for analysis is our decision in Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 96 S.Ct. 2882, 49 L.Ed.2d 752 (1976). In Turner Elkhorn, we considered a constitutional challenge to the retroactive effects of the Federal Coal Mine Health and Safety Act of 1969 as amended by the Black Lung Benefits Act of 1972. Under Title IV of that Act, coal mine operators were required to compensate former employees disabled pneumoconiosis ***729** even though those employees had terminated their work in the industry before the statute was enacted. We nonetheless had little difficulty in upholding the statute against constitutional attack under the Due Process Clause. As we initially noted:

"It is by now well established that legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way. See, e.g., Ferguson v. Skrupa, 372 U.S. 726, 83 S.Ct. 1028, 10 L.Ed.2d 93 (1963); Williamson v. Lee Optical Co., 348 U.S. 483, 487–488, 75 S.Ct. 461, 464, 99 L.Ed. 563 (1955)." 428 U.S., at 15, 96 S.Ct., at 2892.

We further explained that the strong deference accorded legislation in the field of national economic policy is no less applicable when that legislation is applied retroactively. Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational ****2718** means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches:

"[I]nsofar as the Act requires compensation for disabilities bred during employment terminated before the date of enactment, the Act has some retrospective effect—although, as we have noted, the Act imposed no liability on operators until [after its enactment]. And it may be that the liability imposed by the Act for disabilities suffered by former employees was not anticipated at the time of actual employment. But our cases are clear that legislation readjusting rights and burdens is not unlawful solely because it upsets otherwise settled expectations. See Fleming v. Rhodes, 331 U.S. 100, 67 S.Ct. 1140, 91 L.Ed. 1368 (1947); Carpenter v. Wabash R. Co., 309 U.S. 23, 60 S.Ct. 416, 84 L.Ed. 558 (1940); Norman v. Baltimore & Ohio R. Co., 294 U.S. 240, 55 S.Ct. 407, 79 L.Ed. 885 (1935); Home Bldg. & Loan Assn. v. Blaisdell, 290 U.S. 398, 54 S.Ct. 231, 78 L.Ed. 413 (1934); ***730** Louisville & Nashville R. Co. v. Mottley, 219 U.S. 467, 31 S.Ct. 265, 55 L.Ed. 297 (1911). This is true even though the effect of the legislation is to impose a new duty or liability based on past acts. See Lichter v. United States, 334 U.S. 742, 68 S.Ct. 1294, 92 L.Ed. 1694 (1948); Welch v. Henry, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87 (1938); Funkhouser v. Preston Co., 290 U.S. 163, 54 S.Ct. 134, 78 L.Ed. 243 (1933)." Id., at 15–16, 96 S.Ct., at 2892–2893 (footnotes omitted).

[5] To be sure, we went on to recognize that retroactive legislation does have to meet a burden not faced by legislation that has only future effects. "It does not follow ... that what Congress can legislate prospectively it can legislate retrospectively. The retroactive aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffice for the former." Id., at 16–17, 96 S.Ct., at 2892–2893. But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.

For example, in Turner Elkhorn we found that "the imposition of liability for the effects of disabilities bred in the past is justified as a rational measure to spread the costs of the employees' disabilities to those who have profited from the fruits of their labor—the operators and the coal consumers." Id., at 18, 96 S.Ct., at 2893. Similarly, in these cases, a rational legislative purpose supporting the retroactive application of the MPPAA's withdrawal liability provisions is easily identified. Indeed, Congress was quite explicit when explaining the reason for the statute's retroactivity.

[6] **[7]** In particular, we believe it was eminently rational for Congress to conclude that the purposes of the MPPAA could be more fully effectuated if its withdrawal liability provisions were applied retroactively. One of the primary problems Congress identified under ERISA was that the statute encouraged employer withdrawals from multiemployer plans. And Congress was properly concerned that employers would have an even greater incentive to withdraw if they knew that legislation to impose more burdensome liability on withdrawing ***731** employers was being considered. See 126 Cong.Rec. 20179 (1980) (statement of Sen. Javits); id., at 20244 (remarks of Sen. Matsunaga). See also supra, at 2715. Withdrawals occurring during the legislative process not only would have required that remaining employers increase their contributions to existing pension plans, but also could have ultimately affected the stability of the plans themselves. Congress therefore utilized retroactive application of the statute to prevent employers from taking advantage of a lengthy legislative process and withdrawing while Congress debated necessary revisions in the statute. Indeed, as the amendments progressed through the legislative process, Congress advanced the effective date chosen so that it would encompass only that retroactive time period ****2719** that Congress believed would be necessary to accomplish its purposes. As we recently noted when upholding the retroactive application of an income tax statute in United States v. Darusmont, 449 U.S. 292, 296–297, 101 S.Ct. 549, 551–552, 66 L.Ed.2d 513 (1981) (per curiam), the enactment of retroactive statutes "confined to short and limited periods required by the practicalities of producing national legislation ... is a customary congressional practice." We are loathe to reject such a common practice when conducting the limited judicial review accorded economic legislation under the Fifth Amendment's Due Process Clause.

III

Gray and its supporting amici offer several reasons for subjecting the retroactive application of the MPPAA to some form of heightened judicial scrutiny. We are not persuaded, however, by any of their arguments.

First, Gray contends that retroactive legislation does not satisfy due process requirements unless persons affected by the legislation had "notice" of changing legal circumstances and "an opportunity to conform their conduct to the requirements of [the] new legislation." Brief for Appellee 20. We have doubts, however, that retroactive application of the ***732** MPPAA would be invalid under the Due Process Clause for lack of notice even if it was suddenly enacted by Congress without any period of deliberate consideration, as often occurs with floor amendments or "riders" added at the last minute to pending legislation. But even assuming that advance notice of legislative action with retrospective effects is constitutionally compelled, cf. Darusmont, supra, at 299, 101 S.Ct., at 553 (similarly assuming that notice is a relevant consideration), we believe that employers had ample notice of the withdrawal liability imposed by the MPPAA. Not only did ERISA itself impose contingent liability on withdrawing employers, but the various legislative proposals debated by Congress before enactment of the MPPAA uniformly included retroactive effective dates among their provisions. See supra, at 2714–2715. [8]

[8] **[9]** **[10]** Second, it is suggested that we apply constitutional principles that have been developed under the Contract Clause, Art. I, § 10, cl. 1 ("No State shall ... pass any ... Law impairing the Obligation of Contracts ..."), when reviewing this federal legislation. [9] See, e.g., ***733** Energy Resources Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 103 S.Ct. 697, 74 L.Ed.2d 569 (1983); Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 98 S.Ct. 2716, 57

L.Ed.2d 727 (1978). We have never held, however, that the principles embodied in the Fifth Amendment's Due Process Clause are coextensive with prohibitions existing against state impairments of pre-existing contracts. See, e.g., **2720 Philadelphia, B. & W.R. Co. v. Schubert, 224 U.S. 603, 32 S.Ct. 589, 56 L.Ed. 911 (1912). Indeed, to the extent that recent decisions of the Court have addressed the issue, we have contrasted the limitations imposed on States by the Contract Clause with the less searching standards imposed on economic legislation by the Due Process Clauses. See United States Trust Co. v. New Jersey, 431 U.S. 1, 17, n. 13, 97 S.Ct. 1505, 1515, n. 13, 52 L.Ed.2d 92 (1977). And, although we have noted that retrospective civil legislation may offend due process if it is "particularly 'harsh and oppressive,' " ibid. (quoting Welch v. Henry, 305 U.S. 134, 147, 59 S.Ct. 121, 125, 83 L.Ed. 87 (1938), and citing Turner Elkhorn, 428 U.S., at 14–20, 96 S.Ct., at 2891–2894), that standard does not differ from the prohibition against arbitrary and irrational legislation that we clearly enunciated in Turner Elkhorn.

[11] Finally, Gray urges that we resuscitate the Court's 1935 decision in Railroad Retirement Board v. Alton R. Co., 295 U.S. 330, 55 S.Ct. 758, 79 L.Ed. 1468, which invalidated provisions of the Railroad Retirement Act of 1934 that required employers to finance pensions for former railroad employees. Assuming, as we did in Turner Elkhorn, supra, 428 U.S., at 19, 96 S.Ct., at 2894, that this aspect of Alton "retains vitality" despite the changes in judicial review of economic legislation that have occurred in the ensuing years, we again find it distinguishable from the present litigation. Unlike the statute in Alton, which created pensions for employees who had been fully compensated while working for *734 the railroads, the MPPAA merely requires a withdrawing employer to compensate a pension plan for benefits that have already vested with the employees at the time of the employer's withdrawal.

IV

We conclude that Congress' decision to apply the withdrawal liability provisions of the Multiemployer Pension Plan Amendments Act to employers withdrawing from pension plans during the 5–month period preceding enactment of the Act is supported by a rational legislative purpose, and therefore withstands attack under the Due Process Clause of the Fifth Amendment. Accordingly, the judgment of the Court of Appeals is reversed, and the cases are remanded for further proceedings consistent with this opinion.

It is so ordered.

All Citations

467 U.S. 717, 104 S.Ct. 2709, 81 L.Ed.2d 601, 5 Employee Benefits Cas. 1545

Footnotes

[a1] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

[1] The effective date for mandatory insurance coverage of multiemployer plans was subsequently deferred to May 1, 1980, Pub.L. 96–24, 93 Stat. 70, to July 1, 1980, Pub.L. 96–239, 94 Stat. 341, and finally to August 1, 1980, Pub.L. 96–293, 94 Stat. 610. On each occasion, Congress was providing more time for thorough consideration of the complex issues posed by the termination of multiemployer pension plans. Ultimately, mandatory insurance coverage was superseded by the Multiemployer Pension Plan Amendments Act of 1980, Pub.L. 96–364, 94 Stat. 1208.

[2] Congressional testimony by the Executive Director of the PBGC further explained the problems caused by employers withdrawing from multiemployer plans:
"A key problem of ongoing multiemployer plans, especially in declining industries, is the problem of employer withdrawal. Employer withdrawals reduce a plan's contribution base. This pushes the contribution rate for remaining employers to higher and higher levels in order to fund past service liabilities, including liabilities generated by employers no longer participating in the plan, so-called inherited liabilities. The rising costs may encourage—or force—further withdrawals, thereby increasing the inherited liabilities to be funded by an ever-decreasing contribution base. This vicious downward spiral may continue until it is no longer reasonable or possible for the pension plan to continue." Pension Plan Termination Insurance Issues:

Hearings before the Subcommittee on Oversight of the House Committee on Ways and Means, 95th Cong., 2nd Sess., 22 (1978) (statement of Matthew M. Lind).

3 Again, the PBGC's Executive Director provided a more elaborate explanation:

"To deal with this problem, our report considers an approach under which an employer withdrawing from a multiemployer plan would be required to complete funding its fair share of the plan's unfunded liabilities. In other words, the plan would have a claim against the employer for the inherited liabilities which would otherwise fall upon the remaining employers as a result of the withdrawal....

"We think that such withdrawal liability would, first of all, discourage voluntary withdrawals and curtail the current incentives to flee the plan. Where such withdrawals nonetheless occur, we think that withdrawal liability would cushion the financial impact on the plan." Id., at 23 (statement of Matthew M. Lind).

4 Gray also moved for a preliminary injunction to restrain the Pension Plan from taking any further steps to collect the withdrawal liability it assessed. The District Court denied that motion. App. 50–57.

At the same time, Gray requested that the Pension Plan review its determination of withdrawal liability. See 29 U.S.C. § 1399(b)(2). In response, the Pension Plan issued a "Decision on Review," concluding that it had "accurately determined: (1) the method for allocating the unfunded vested benefits to Gray, (2) the amount of the Plan's unfunded vested benefits, (3) the schedule of payments offered to Gray, and (4) the date of Gray's complete withdrawal." 549 F.Supp. 531, 534 (Ore.1982). Although Gray could have initiated arbitration with the Pension Plan on these issues, 29 U.S.C. § 1401(a), it accepted these findings and waived its right to arbitration, 549 F.Supp., at 534.

5 Gray also contended, inter alia, that the different treatment afforded employers participating in multiemployer pension plans as opposed to employers participating in single-employer pension plans violates the equal protection component of the Fifth Amendment, that retroactive application of the MPPAA violates the Ex Post Facto Clause included in Art. I, § 9, of the Constitution, and that the Act's arbitration provisions violated Gray's rights to procedural due process and trial by jury. The District Court rejected the first two claims, see 549 F.Supp., at 538–539, and refused to reach the last claim because Gray had waived its right to arbitration, id., at 539; n. 4, supra. These issues were not reached by the Court of Appeals, Shelter Framing Corp. v. Pension Benefit Guaranty Corp., 705 F.2d 1502, 1515 (CA9 1983), and are not now pressed before this Court.

6 The court in Nachman developed this four-part test for reviewing the constitutionality of retroactive legislation under the Fifth Amendment's Due Process Clause primarily by relying upon this Court's decisions in Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 98 S.Ct. 2716, 57 L.Ed.2d 727 (1978), and Railroad Retirement Board v. Alton R. Co., 295 U.S. 330, 55 S.Ct. 758, 79 L.Ed. 1468 (1935). For reasons explained below, however, we do not believe that these cases control judicial review of retroactive federal legislation affecting economic benefits and burdens. See infra, at 2719–2720. We therefore reject the constitutional underpinnings of the analysis employed by the Court of Appeals in Nachman, although we have no occasion to consider whether the factors mentioned by that court might in some circumstances be relevant in determining whether retroactive legislation is rational. Cf. Nachman Corp. v. Pension Benefit Guaranty Corp., 446 U.S. 359, 367–368, and n. 12, 100 S.Ct. 1723, 1729–1730, and n. 12, 64 L.Ed.2d 354 (1980) (explicitly limiting our review to the statutory question presented).

7 At least three Courts of Appeals, as well as numerous District Courts, have concluded that retroactive application of the MPPAA's withdrawal liability provisions satisfies constitutional standards. See, e.g., Textile Workers Pension Fund v. Standard Dye & Finishing Co., 725 F.2d 843 (CA2 1984); Peick v. Pension Benefit Guaranty Corp., 724 F.2d 1247 (CA7 1983), cert. pending, 465 U.S. 1098, 104 S.Ct. 1588, 80 L.Ed.2d 121; Republic Industries, Inc. v. Teamsters Joint Council, 718 F.2d 628 (CA4 1983), cert. pending, No. 83–541.

The prospective application of the MPPAA's withdrawal liability provisions has also been the subject of extensive nationwide litigation. All of the Courts of Appeals addressing the various constitutional challenges raised in those cases, however, have upheld the statute. See, e.g., The Washington Star Co. v. International Typographical Union Negotiated Pension Plan, 235 U.S.App.D.C. 1, 729 F.2d 1502 (1984); Peick v. Pension Benefit Guaranty Corp., supra; Republic Industries, Inc. v. Teamsters Joint Council, supra. Because these issues were not addressed by the Court of Appeals, cf. n. 5, supra, and are not actively pursued by the parties before this Court, we assume for purposes of our decision in these cases that the prospective effects of the Act satisfy constitutional standards.

8 See, e.g., Textile Workers Pension Fund v. Standard Dye & Finishing Co., 725 F.2d, at 852 ("Notice was everywhere.... [Employers] withdrew from their funds not only when pervasive regulation, including withdrawal liability under ERISA, existed in the pension field, but also when the advent of the MPPAA was imminent"); Peick v. Pension Benefit Guaranty Corp., 724 F.2d, at 1269 ("[T]he intent of Congress to provide for the retrospective imposition of liability was quite clear from the very beginning of the legislative process.... [E]mployers who withdrew during [[[[[the retrospective] period cannot argue that they are now being required to pay wholly unanticipated liabilities" (footnote omitted).

[9] It could not justifiably be claimed that the Contract Clause applies, either by its own terms or by convincing historical evidence, to actions of the National Government. Indeed, records from the debates at the Constitutional Convention leave no doubt that the Framers explicitly refused to subject federal legislation impairing private contracts to the literal requirements of the Contract Clause:

"MR. GERRY entered into observations inculcating the importance of public faith, and the propriety of the restraint put on the states from impairing the obligation of contracts; alleging that Congress ought to be laid under the like prohibitions. He made a motion to that effect. He was not seconded." 5 J. Elliott, Debates on the Federal Constitution 546 (2 ed. 1876). See 2 M. Ferrand, Records of the Federal Convention of 1787, p. 619 (1911).

End of Document

TAB 84

354 F.Supp.2d 260
United States District Court,
S.D. New York.

Fred SMIT, as Chairman of the Board of Trustees of
Teamsters Local 445 Freight Division Pension Fund, Plaintiff,
v.
ISIKLAR HOLDING A.S. a/k/a Isiklar Group a/k/a Powell & Minnock Brick Works, Inc., Isiklar Yapi Holding (World Construction Holding), Isiklar Ambalaj, Isiklar Insaat Malzemeleri a/k/a Isiklar Building Materials, Inc. a/k/a Isiklar Tugla, Isiklar Cemas a/k/a Isiklar Cimtek a/k/a Cimtek Cimento Teknolojisi Muhendislik A.S., Isiklar Nigbas, Isiklar Ozisik, Isiklar Bartin Tugla Fabrikisi Sanayi Ve Ticaret A.S., Isiklar Denizcilik a/k/a Isiklar Denizcilik Ve Ticaret a/k/a Denizcilik Sanayi Ve Ticaret, A.S., Isiklar Pazarlama, A.S., Isiklar Yapi Dekorasyon Sanayi Ve Ticaret A.S., Defendants.

No. 04 CIV. 733(CM).
|
Jan. 7, 2005.

Synopsis
Background: Pension fund brought action against Turkish corporations, alleging failure to pay assessed withdrawal liability owed to fund under Employee Retirement Income Security Act (ERISA). Corporations moved to dismiss for lack of personal jurisdiction.

Holdings: The District Court, McMahon, J., held that:

[1] court had personal jurisdiction over corporation that allegedly had contractual relationship with fund, and

[2] court lacked jurisdiction over corporations without contractual relationships.

Motion granted in part and denied in part.

Attorneys and Law Firms

***262** Kellie Terese Walker, Sapir & Frumkin LLP, White Plains, NY, for Plaintiff.

David A. Strassburger, Strassburger McKenna Gutnick & Potter, Pittsburgh, PA, Paul Hugo Galligan, Gary Herbert Glaser, Seyfarth Shaw LLP, New York City, Timothy A. Fedele, Strassburger McKenna Gutnick & Potter, Greenburg, PA, for Defendants.

DECISION AND ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTION TO DISMISS

MCMAHON, District Judge.

This is an action to recover withdrawal liability payments allegedly owed to a pension fund.

Plaintiff, Fred Smit, is Chairman of the Board of Teamsters Local 445 Freight Division Pension Fund, [1] which is a multi-employer pension benefit plan under the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1001, *et seq.* (First Amended Complaint, dated October 15, 2004 ("Complaint") ¶ 2.) Plaintiff alleges that defendants owe the Fund $804,267.46, interest and liquidated damages, plus attorney's fees and costs, as a result of their failure to make payment of an assessed withdrawal liability owed to the Fund in accordance with ERISA, as amended by the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA"), 29 U.S.C. § 1381, *et seq.* (Cmpl.¶ 2.)

All defendants are Turkish corporations with their principal places of business in Turkey. (Cmpl.¶¶ 27–37.) Plaintiff claims that personal jurisdiction over the defendants is properly exercised under Federal Rule of Civil Procedure 4(k)(2) ("Rule 4(k)(2)") and § 4301(d) of the MPPAA, 29 U.S.C. § 1451(d), "in that Defendant Isiklar [Holding A.S.] is subject to jurisdiction based on [its] contacts with the United States of America, as a whole, and New York State with respect to its failure to pay withdrawal liability in violation of §§ 4219(c)(2) and 4221(b)(1) of the MPPAA, 29 U.S.C. §§ 1399(c)(2) and 1401(b)(1)." [2] (Cmpl.¶ 4.) As discussed more fully below, plaintiff also appears to argue, in the alternative, that personal jurisdiction is proper under Fed.R.Civ.P. 4(k)(1) ("Rule 4(k)(1)"), by virtue of New York's long-arm statute, C.P.L.R. § 302 (" § 302").

All defendants dispute plaintiff's characterization of their presence and activities in the United States and New York and move to dismiss the action for lack of personal jurisdiction, pursuant to Fed.R.Civ.P. 12(b)(2). There has been no jurisdictional discovery to date.

As discussed more fully below, all of defendant Isiklar Holding A.S.'s ("Isiklar Holding") alleged pension obligations to plaintiff appear to have originated with the ***263** 1994 stock purchase of a New York corporation not separately named in this suit, Powell and Minnock Brick Works, Inc ("Powell and Minnock"). [3] (*See, e.g.,* Cmpl. ¶¶ 5, 6.) Jurisdictional allegations regarding Isiklar Holding include the 1994 stock purchase (and subsequent breach of the stock purchase agreement), as well as various activities in New York and elsewhere in the United States. The other defendants' (the "non-Isiklar Holding defendants") [4] putative pension obligations—as well as this court's exercise of personal jurisdiction over them—are alleged to arise solely from their relationship with Isiklar Holding. Because I find no independent allegations in the Complaint that would support the court's exercise of personal jurisdiction over these entities, I dismiss the case with respect to the 10 non-Isiklar Holding defendants. I do find, however, that Plaintiff has pleaded a *prima facie* showing of personal jurisdiction over Isiklar Holding, which shall remain a party to this suit, subject to further discovery on the issue.

I. Standard and Applicable Law

A. Motion to Dismiss

[1] [2] [3] It is a plaintiff's burden to establish the propriety of a court's exercise of personal jurisdiction over parties to the suit. *See In re Commodore Int'l, Ltd.,* 242 B.R. 243, 250 (Bkrtcy.S.D.N.Y.1999) (citing *Falik v. Smith,* 884 F.Supp. 862, 864 (S.D.N.Y.1995)). When a motion challenging personal jurisdiction is presented before discovery has been conducted on that issue, the plaintiff may defeat the motion by pleading a *prima facie* showing of personal jurisdiction over defendants. *Jazini v. Nissan Motor Co.,* 148 F.3d 181, 184 (2d Cir.1998); *Ball v. Metallurgie Hoboken–Overpelt, S.A.,* 902 F.2d 194, 197 (2d Cir.1990). All pleadings and affidavits "are construed in the light most favorable to plaintiff, and where doubt exists, they are resolved in plaintiff's favor." *Gmurzynska,* 257 F.Supp.2d at 625; *see also Mutualidad Seguros Del Instituto Nacional De Industria v. M.V. Luber,* No. 95–Civ. 10988KMWLB, 1998 WL 1108936 *1 (S.D.N.Y. Sept. 25, 1998); *Turbana Corp. v. M/V "SUMMER MEADOWS",* No. 03–Civ. 2099(HB), 2003 WL 22852742 *1 (S.D.N.Y. Dec. 2, 2003) (not reported).

[4] [5] [6] In its discretion, a district court may determine the issue of personal jurisdiction on the basis of affidavits alone, or it may order discovery on the issue. *See, e.g., Marine Midland Bank, N.A. v. Miller,* 664 F.2d 899, 904 (2d

Cir.1981); *see also Mutualidad,* 1998 WL 1108936 at *2. Specifically, if plaintiff has not pleaded a *prima facie* showing of personal jurisdiction, a court may order limited discovery "targeted at the missing jurisdictional elements," if plaintiff has shown that such an exercise "would serve to *fill any holes* in its showing." *Turbana,* 2003 WL 22852742 at * 2 (emphasis added). The pleadings must indicate, however, that limited ***264** discovery is likely to uncover additional facts supporting jurisdiction; a court will not draw "argumentative inferences" in favor of a plaintiff who has failed to allege even bare facts to support a finding of personal jurisdiction over defendants. *See Robinson v. Overseas Military Sales Corp.,* 21 F.3d 502, 507 (2d Cir.1994) (citing *Atlantic Mutual Ins. Co. v. Balfour Maclaine Int'l Ltd.,* 968 F.2d 196, 198 (2d Cir.1992)).

[7] Once the plaintiff has made a threshold showing of minimum contacts and satisfaction of due process requirements to support the exercise of personal jurisdiction, the burden shifts to defendant to present compelling facts showing that personal jurisdiction is otherwise unreasonable. *Metropolitan Life Ins. Co. v. Robertson–Ceco Corp.,* 84 F.3d 560, 568 (2d Cir.1996).

B. Applicable Statutes

In the Complaint, plaintiff asserts that personal jurisdiction is proper under Rule 4(k)(2), but does not expressly assert any other basis for personal jurisdiction. (Cmpl.¶ 4.)

Rule 4(k)(2) provides:

> If the exercise of jurisdiction is consistent with the Constitution and laws of the United States, serving a summons or filing a waiver of service is also effective, with respect to claims arising under federal law, to establish personal jurisdiction over the person of any defendant who is not subject to the jurisdiction of the courts of general jurisdiction of any state.

Thus, Rule 4(k)(2) requires proof that (1) plaintiff's claim arises under federal law; (2) the defendant is beyond the jurisdictional reach of any state court of general jurisdiction; and (3) the federal court's exercise of personal jurisdiction over the defendant does not offend the Constitution or other federal law. *See United States v. Swiss American Bank, Ltd.,* 191 F.3d 30, 38 (1st Cir.1999). At this stage, plaintiff need only make a *prima facie* showing of the elements listed above.

Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss, dated November 23, 2004 ("plaintiff's brief") also argues that this Court has jurisdiction over defendants pursuant to New York's long-arm statute, C.P.L.R. § 302, presumably by way of Fed.R.Civ.P. 4(k)(1) ("Rule 4(k)(1)"). Rule 4(k)(1) provides, in pertinent part, that, "Service of a summons ... is effective to establish jurisdiction over the person of a defendant ... who could be subjected to the jurisdiction of a court of general jurisdiction in the state in which the district court is located."

Since plaintiff's brief argues that the defendants may not be subject to jurisdiction in any state, and his arguments rely on allegations pleaded in the Complaint, I construe the Complaint as trying to make out a claim of personal jurisdiction under Rule 4(k)(2) or, in the alternative, Rule 4(k)(1) by way of § 302. *See Dale v. Banque SCS Alliance,* No. 02 Civ. 3592, 2004 WL 2389894 at *3 (S.D.N.Y. Oct. 22, 2004) (noting that jurisdictional allegations are to be construed liberally in plaintiff's favor).

[8] New York C.P.L.R. § 302(a)(1) provides that a party is subject to personal jurisdiction in New York if it transacts business within the state. A single transaction will support the exercise of jurisdiction, but the cause of action must arise out of the defendant's contact with New York. *Id.; see also Dale* at 2004 WL 2389894 *4–5.

[9] **[10]** **[11]** "An entity is deemed to be transacting business in New York [under § 302(a)(1)] when he purposefully avails himself of the privilege of conducting activities within New York." ***265** *Turbana,* 2003 WL 22852742 at *4 (citing *CutCo Indus., Inc. v. Naughton,* 806 F.2d 361, 365 (2d Cir.1986) (internal quotations omitted)). Factors to be considered are: whether the defendant has an ongoing contractual relationship with a New York corporation, whether the contract was negotiated or executed in New York, whether the defendant visited New York for the purpose of meeting with the parties to the agreement, and the choice of law clause in the agreement. *Id.* (citing *Sunward Electronics, Inc. v. McDonald,* 362 F.3d 17, 22 (2d Cir.2004)). The execution of an agreement in New York, without more, does not constitute "transacting business" in New York for purposes of § 302. *In re Commodore,* 242 B.R. at 254.

Plaintiff does not make any reference, in its brief or the Complaint, to New York C.P.L.R. § 301 ("§ 301"), which provides for jurisdiction over a party who regularly transacts business in New York, such that it may expect to be haled into court here even on matters not relating to its contacts with the state. Section 301 may apply here, however, as plaintiff asserts numerous allegations of Isiklar Holdings' general presence in New York.

[12] **[13]** **[14]** New York C.P.L.R. § 301 confers personal jurisdiction over " 'persons, property or status as might have been exercised heretofore,' that is, under the case law in force prior to the enactment of C.P.L.R. § 301." *Dale,* 2004 WL 2389894 at *3 (quoting *Hoffritz for Cutlery, Inc. v. Amajac, Ltd.,* 763 F.2d 55, 57–58 (2d Cir.1985)). Section 301 requires "a continuous and systematic course of doing business [in New York] as to warrant a finding of its presence in [that] jurisdiction." *Semi Conductor Materials, Inc. v. Citibank Int'l PLC,* 969 F.Supp. 243, 245 (S.D.N.Y.1997) (internal citations omitted). A corporation is "present and doing business in New York, with respect to any cause of action, related or unrelated to [its] New York contacts, if it does business in New York 'not occasionally or casually, but with a fair measure of permanence and continuity.' " *Dale,* 2004 WL 2389894 at *3 (quoting *Hoffritz for Cutlery, Inc.,* 763 F.2d at 58) (internal quotations omitted). Factors traditionally considered in this analysis include: whether the foreign corporation has a New York office; whether it solicits business in New York; the presence of bank accounts or other property in New York, and the presence of employees in New York. *Id.* at 2004 WL 2389894 *4.

II. Analysis

A. Isiklar Holding

Plaintiff makes the following allegations in the Complaint in support of personal jurisdiction over Isiklar Holding:

- Isiklar Holding acquired all of the outstanding stock of two U.S. corporations, including Powell and Minnock, from seller Carmeuse Lime, Inc., a Delaware corporation, by way of a Stock Purchase Agreement, dated April 28, 1994 (the "SPA"). (Cmpl.¶¶ 5, 6.)

- According to the SPA, Isiklar Holding agreed to maintain the physical assets used in Powell and Minnock's business consistent with the past practices of the business, (*id.*), agreed to follow all applicable federal and state laws and was obligated to provide accrued and future pension benefits to eligible employees of Powell and Minnock. (Compl.¶¶ 7, 8.)

- Isiklar Holding had Pennsylvania counsel in connection with the SPA. (Cmpl. ¶ 18.)

- Isiklar Holding at one time owned property in Coeymans, New York, which it conveyed to P & M Brick, LLC, a New York limited liability company, in 2002. (Cmpl.¶ 11.) Dr. ***266** Unal Gogus ("Gogus") signed the deed in his capacity as treasurer of Isiklar Holding and/or Powell and Minnock. (*Id.*)

- Isiklar Holding is merely the "alter ego" of Powell and Minnock and is "a/k/a," or, also known as, Powell and Minnock. (Cmpl.¶¶ 8, 15, 38.) [5]

- Isiklar Holding is a "single employer" with Powell and Minnock for purposes of ERISA. (Cmpl.¶ 39, 40.)

- Isiklar Holding and/or Powell and Minnock "was an employer affecting interstate commerce and conducted business" in New York. (Cmpl.¶ 43.)

- During the relevant period, Gogus was treasurer of Powell and Minnock, and at the same time was an officer or director of Isiklar Holding and other defendants. (Cmpl.¶¶ 9, 10.)

- Gogus "often" traveled to New York for Isiklar Holding and/or Powell and Minnock business. (Cmpl.¶ 13.)

- Gogus signed at least one letter in his capacity as Powell and Minnock treasurer on Isiklar Holding letterhead. (Cmpl.¶ 12.)

- Isiklar Holding and/or Powell and Minnock entered into collective bargaining agreements and memoranda of agreements with the Local 445, which obligated Isiklar Holding and/or Powell and Minnock to make payments to the Fund. [6] (Cmplt.¶ 8.)

- Gogus represented Isiklar Holding and/or Powell and Minnock in a grievance arbitration with labor unions, including the Local 445 regarding contributions owed to the Fund. (Cmpl.¶ 10.)

- In January, 2003, an arbitrator for the American Arbitration Association (the "arbitrator") concluded that Isiklar Holding was liable for the breach of labor agreements committed by Powell and Minnock for, *inter alia,* failing to pay contributions to "Plaintiff Local 445 Pension Fund." (Cmpl.¶ 14.)

- Isiklar Holding and/or Powell and Minnock "conducted business in the United States and New York by virtue of the operation of its business under the name 'Powell and Minnock Brick Works, Inc.,' located on Route 144 in Coeymans, New York. (Cmpl.¶ 15.)

- Isiklar Holding maintained "minimum contacts with the United States and New York by purposefully availing itself of the privilege of conducting business in the United States and New York as evidenced by its acts and conduct in the two forums which relate to the claims alleged herein." (Cmpl.¶ 16.)

- The Fund is administered in Newburgh, New York. (Cmpl.¶¶ 21, 25.)

[15] These allegations, conclusory though they be, are sufficient to make a ***267** *prima facie* showing of personal jurisdiction over Isiklar Holding. Plaintiff is alleging that Powell and Minnock was a corporation doing business in New York, that Powell and Minnock made contributions to the Fund pursuant to an agreement with the Plan, that Isiklar Holding purchased Powell and Minnock and agreed by contract to continue making those contributions (whether as Isiklar Holding or as Powell and Minnock is unclear at this stage). Isiklar Holding is alleged to have entered a contract with the Fund by entering into a contractual relationship via the SPA and the collective bargaining agreements, which obligated the employer to continue providing pension benefits after Isiklar Holding purchased Powell and Minnock. In addition, plaintiff alleges that Isiklar Holding did business in New York under the Powell and Minnock name (it is not clear from the pleadings whether Powell and Minnock has been dissolved or merged into Isiklar Holding or some other entity).

These allegations, at a minimum, state a claim that Isiklar Holding entered into or assumed obligations under a contract in the state of New York and obligated itself to perform that contract on an ongoing basis in New York. Finally, there appear to be allegations that Isiklar Holding is the alter ego of Powell and Minnock, as to which plaintiff is entitled to discovery.

For these reasons, I find that plaintiff has pleaded a *prima facie* case of jurisdiction over Isiklar Holding, and defendants' motion must be denied with respect to that entity. *See, e.g., Dardana Ltd. v. A.O. Yuganskneftegaz,* 317 F.3d 202, 205–206 (2d Cir.2003) (finding plaintiff entitled to discovery on the issue of jurisdiction under Rule 4(k)(2) and N.Y.C.P.L.R.

§ 301 where defendant was alleged to have signed a contract in New York, were alleged to have solicited and transacted business in New York and planned to issue American Depository Receipts).

B. Non–Isiklar Holding Defendants

[16] The only connection the non-Isiklar Holding defendants are alleged to have to the present action is their affiliation with Isiklar Holding. Specifically, plaintiff claims that:

- The non-Isiklar Holding defendants are members of the "controlled group" of corporations under "common control" with Isiklar Holding. (Cmpl.¶¶ 56–59, 63–65, 70–72, 77–79, 84–86, 91–93, 98–100, 105–07, 112–14, 119–21.), and

- All defendants constitute a "single employer" doing business in New York for purposes of ERISA and MPPAA. (Cmpl.¶ 20, 39, 40.)

There appear to be no separate allegations that the non-Isiklar Holding entities were present doing business in New York or the United States, nor that they were derelict in any individual obligations to the Fund.

These bare statements are not enough to sustain personal jurisdiction—or even discovery on that issue. First, plaintiff conflates ERISA subject matter jurisdiction and the due process analysis required for personal jurisdiction. *See, e.g., International Shoe Co. v. Washington,* 326 U.S. 310, 66 S.Ct. 154, 90 L.Ed. 95 (1945). Even if ERISA considers all the defendants a "single employer" and a "controlled group" under "common control" with Isiklar Holding—issues I need not reach here—it would not empower this Court to impute the actions of one entity to another for purposes of establishing personal jurisdiction over foreign defendants. Only if I were to decide that this Court had personal jurisdiction over the non-Isiklar Holding defendants would I then look to ERISA and MPPAA to determine whether they were jointly and severally ***268** liable for Isiklar Holding's payments due to the Fund under the SPA.

Accordingly, defendants' motion is granted and the case is dismissed with respect to the non-Isiklar Holding defendants. *See, e.g., Dale,* 2004 WL 2389894 at *5 (refusing to order jurisdiction discovery under §§ 301 or 302 or Rule 4(k)(2) where plaintiff failed to make a *prima facie* showing of personal jurisdiction, even though plaintiff did allege that defendant had used a correspondent bank account in New York to further alleged fraud, because defendants had not "projected" themselves into New York to do business); *In re Commodore,* 242 B.R. at 251 (finding no jurisdiction under C.P.L.R. § 301 where plaintiff failed to allege any facts separate from managers' and directors' numerous trips to New York to solicit business); *Turbana,* 2003 WL 22852742 at *2 (finding bank account in New York insufficient to support personal jurisdiction where there was no allegation that defendant transacted business from that account); *Robinson,* 21 F.3d at 511 (phone call to New York insufficient basis for jurisdiction under § 302 where defendants never lived in, worked in, traveled to or through or visited New York); *Mutualidad,* 1998 WL 1108936 at *2 (finding defendant did not "purposefully avail itself of the privileges of conducting business" in the U.S. where plaintiff failed to allege that defendant had property in the U.S., had agents or bank accounts in the U.S., or advertised, made sales calls or otherwise solicited business in the U.S., apart from a contract with a Louisiana entity and allowing its vessel to stop at a U.S. port); *see also, e.g., Glencore Grain Rotterdam B.V. v. Shivnath Rai Harnarain Co.,* 284 F.3d 1114, 1128 (9th Cir.2002) (noting that personal jurisdiction should be based on a defendant's person or property, not on a statute conferring subject matter jurisdiction).

Conclusion

For the foregoing reasons, defendants' motion is granted to the extent that this case is dismissed for lack of personal jurisdiction over the non-Isiklar Holding defendants, namely: Isiklar Yapi Holding (World Construction Holding), Isiklar Ambalaj, Isiklar Insaat Malzemeleri a/k/a Isiklar Building Materials, Inc. a/k/a Isiklar Tugla, Isiklar Cemas a/k/a Isiklar Cimtek a/k/a Cimtek Cimento Teknolojisi Muhendislik A.S., Isiklar Nigbas, Isiklar Ozisik, Isiklar Bartin Tugla Fabrikisi Sanayi Ve Ticaret A.S., Isiklar Denizcilik a/k/a Isiklar Denizcilik Ve Ticaret a/k/a Denizcilik Sanayi Ve Ticaret, A.S., Isiklar Pazarlama, A.S., Isiklar Yapi Dekorasyon Sanayi Ve Ticaret A.S.

The motion is denied with respect to defendant Isiklar Holding A.S.

The remaining parties will conduct discovery on the issue of personal jurisdiction over defendant Isiklar Holding A.S. under N.Y.C.P.L.R. §§ 301 and 302 and Fed.R.Civ.P. 4(k)(2) on a schedule to be set by this Court at the previously scheduled conference with the parties on Friday, January 7, 2005 at 9:30 a.m.

Finally, attorneys for defendants, David A. Strassburger and Timothy A. Fedele of the law firm Strassburger, McKenna, Gutnick & Potter, P.C., and Gary Glaser and Paul Galligan, of the firm Seyfarth Shaw LLP, submitted a bare proposed order seeking leave to withdraw on January 3, 2005. They submitted no supporting papers, gave no reason, and included nothing indicating that notice had been given to their clients. I cannot sign this order without more information. The attorneys are ordered to appear for the scheduled conference in this Court on January 7, 2005 at 9:30 a.m., at which time they should be prepared to explain why they wish to withdraw.

*269 *Instruction to the Clerk of the Court*

The Clerk of the Court is instructed to dismiss the case with respect to defendants Isiklar Yapi Holding (World Construction Holding), Isiklar Ambalaj, Isiklar Insaat Malzemeleri a/k/a Isiklar Building Materials, Inc. a/k/a Isiklar Tugla, Isiklar Cemas a/k/a Isiklar Cimtek a/k/a Cimtek Cimento Teknolojisi Muhendislik A.S., Isiklar Nigbas, Isiklar Ozisik, Isiklar Bartin Tugla Fabrikisi Sanayi Ve Ticaret A.S., Isiklar Denizcilik a/k/a Isiklar Denizcilik Ve Ticaret a/k/a Denizcilik Sanayi Ve Ticaret, A.S., Isiklar Pazarlama, A.S., Isiklar Yapi Dekorasyon Sanayi Ve Ticaret A.S.

The case is to remain open with respect to defendant Isiklar Holding A.S.

This constitutes the decision and order of the Court.

All Citations

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Footnotes

[1] The union is referred to hereinafter as the "Local 445," and its pension fund as the "Fund."

[2] Plaintiff asserts, and defendants do not contest, that this Court has subject matter jurisdiction pursuant to §§ 502(e), 502(f) and 4301(c) of ERISA, as amended, 29 U.S.C. §§ 1132(e), 1132(f) and 1451(c). (Cmpl.¶ 3.)

[3] Powell and Minnock is named to the extent that it is included as an alias of Isiklar Holding, "Isiklar Holding A.S. a/k/a Isiklar Group a/k/a Powell and Minnock Brick Works, Inc," an allegation addressed below. Plaintiff alleges that Powell and Minnock "permanently ceased to have an obligation to contribute to [the Fund] and/or permanently ceased all operations covered by the applicable Labor Agreements" in 2002. (Cmpl.¶ 46.)

[4] The non-Isiklar Holding defendants are Isiklar Yapi Holding (World Construction Holding), Isiklar Ambalaj, Isiklar Insaat Malzemeleri a/k/a Isiklar Building Materials, Inc. a/k/a Isiklar Tugla, Isiklar Cemas a/k/a Isiklar Cimtek a/k/a Cimtek Cimento Teknolojisi Muhendislik A.S., Isiklar Nigbas, Isiklar Ozisik, Isiklar Bartin Tugla Fabrikisi Sanayi Ve Ticaret A.S., Isiklar Denizcilik a/k/a Isiklar Denizcilik Ve Ticaret a/k/a Denizcilik Sanayi Ve Ticaret, A.S., Isiklar Pazarlama, A.S., Isiklar Yapi Dekorasyon Sanayi Ve Ticaret A.S.

[5] Plaintiff consistently refers to Isiklar Holding as "Isiklar a/k/a Powell and Minnock." As discussed more fully below, while it is not necessary (or possible) at this stage in the proceedings to decide whether these entities are in fact alter egos, allegations in support of this assertion are central to the instant motion. *See United States v. Swiss American Bank, Ltd.,* 191 F.3d 30, 46 (1st Cir.1999) (noting that a court should resolve issues of personal jurisdiction before analyzing whether one entity is the alter ego of another). Thus, where possible, I refer to Isiklar Holding and Powell and Minnock separately, in order to comprehend the factual allegations relied upon by plaintiff in support of personal jurisdiction over the foreign defendants. For purposes of this motion, I will construe these allegations liberally and assume they apply to Isiklar Holding wherever possible. *See, e.g., Gmurzynska v. Hutton,* 257 F.Supp.2d 621, 625 (S.D.N.Y.2003).

[6] It is not clear from the Complaint whether these labor agreements were entered before or after the SPA, and thus, whether Isiklar Holding or Powell and Minnock executed them.

End of Document

TAB 85

S.B.C. 2002, c. 57, s. 154

s 154. Directors' liability

Currency

154.Directors' liability

154(1) Subject to section 157, directors of a company who vote for or consent to a resolution that authorizes the company to do any of the following are jointly and severally liable to restore to the company any amount paid or distributed as a result and not otherwise recovered by the company:

(a) to do an act contrary to section 33(1) as a result of which the company has paid compensation to any person;

(b) to pay a commission or allow a discount contrary to section 67;

(c) to pay a dividend contrary to section 70(2);

(d) to purchase, redeem or otherwise acquire shares contrary to section 78 or 79;

(e) to make a payment or give an indemnity contrary to section 163;

(f) in the case of a director of a community contribution company, to do an act contrary to Part 2.2 as a result of which act the company has transferred any of its money or other assets to any person.

154(2) Subject to subsection (4) of this section and section 157, directors of a company who vote for or consent to a resolution that authorizes the issue of a share in contravention of section 63(2)(b) or 64 are jointly and severally liable to compensate the company, or any shareholder or beneficial owner of shares of the company, for any losses, damages and costs sustained or incurred as a result by the company, the shareholder or the beneficial owner, as the case may be.

154(3) The liability imposed by subsections (1) and (2) of this section is in addition to and not in derogation of any liability imposed on a director by this Act or any other enactment or by any rule of law or equity.

154(4) A director is not liable under subsection (2) if the director did not know and could not reasonably have known that the value of the consideration for which the share was issued was less than the issue price set for the share under section 63.

154(5) For the purposes of this section, a director of a company who is present at a meeting of the directors or of a committee of directors is deemed to have consented to a resolution referred to in subsection (1) or (2) of this section that is passed at the meeting unless that director's dissent

(a) is recorded in the minutes of the meeting,

(b) is put in writing by the director and is provided to the secretary of the meeting before the end of the meeting, or

(c) is, promptly after the end of the meeting, put in writing and delivered to the delivery address of, or mailed by registered mail to the mailing address of, the company's registered office.

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154(6) A director who votes in favour of a resolution referred to in subsection (1) or (2) is not entitled to dissent under subsection (5).

154(7) Subject to subsection (8), a director who is not present at a meeting of the directors or of a committee of directors at which a resolution referred to in subsection (1) or (2) is passed is deemed to have consented to the resolution if,

(a) in the case of a resolution passed at a directors' meeting, the individual was a director at the time of the meeting, or

(b) in the case of a resolution passed at a meeting of a committee of directors, the individual was a member of that committee at the time of the meeting.

154(8) Subsection (7) does not apply to a director who, within 7 days after becoming aware of the passing of a resolution referred to in subsection (1) or (2), delivers to the delivery address of, or mails by registered mail to the mailing address of, the company's registered office, a written dissent.

154(9) A legal proceeding to enforce a liability imposed by this section may not be commenced more than 2 years after the date of the applicable resolution.

Amendment History
2012, c. 12, s. 9

Currency
British Columbia Current to B.C. Reg. 260/2016 (November 1, 2016)

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TAB 86

R.S.O. 1990, c. B.16, s. 243

s 243.

Currency

243.
243(1)Liability of shareholders to creditors
Despite the dissolution of a corporation, each shareholder to whom any of its property has been distributed is liable to any person claiming under section 242 to the extent of the amount received by that shareholder upon the distribution, and an action to enforce such liability may be brought.

243(2)Party action
The court may order an action referred to in subsection (1) to be brought against the persons who were shareholders as a class, subject to such conditions as the court thinks fit and, if the plaintiff establishes his, her or its claim, the court may refer the proceedings to a referee or other officer of the court who may,

(a) add as a party to the proceedings before him or her each person who was a shareholder found by the plaintiff;

(b) determine, subject to subsection (1), the amount that each person who was a shareholder shall contribute towards satisfaction of the plaintiff's claim; and

(c) direct payment of the amounts so determined.

243(3)Definition
In this section, **"shareholder"** includes the heirs and legal representatives of a shareholder.

Amendment History
2002, c. 24, Sched. B, s. 27(2)

Currency
Ontario Current to Gazette Vol. 149:50 (December 10, 2016)

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TAB 87

Canada Federal Statutes
Canada Business Corporations Act
Part X — Directors and Officers (ss. 102-125)

R.S.C. 1985, c. C-44, s. 119

s 119.

Currency

119.
119(1)Liability of directors for wages
Directors of a corporation are jointly and severally, or solidarily, liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.

119(2)Conditions precedent to liability
A director is not liable under subsection (1) unless

(a) the corporation has been sued for the debt within six months after it has become due and execution has been returned unsatisfied in whole or in part;

(b) the corporation has commenced liquidation and dissolution proceedings or has been dissolved and a claim for the debt has been proved within six months after the earlier of the date of commencement of the liquidation and dissolution proceedings and the date of dissolution; or

(c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the debt has been proved within six months after the date of the assignment or bankruptcy order.

119(3)Limitation
A director, unless sued for a debt referred to in subsection (1) while a director or within two years after ceasing to be a director, is not liable under this section.

119(4)Amount due after execution
Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

119(5)Subrogation of director
A director who pays a debt referred to in subsection (1) that is proved in liquidation and dissolution or bankruptcy proceedings is entitled to any priority that the employee would have been entitled to and, if a judgment has been obtained, the director is

(a) in Quebec, subrogated to the employee's rights as declared in the judgment; and

(b) elsewhere in Canada, entitled to an assignment of the judgment.

119(6)Contribution
A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

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Amendment History

1992, c. 27, s. 90(1)(h); 2001, c. 14, ss. 47(1), 135 (Sched., s. 42); 2004, c. 25, s. 187; 2011, c. 21, s. 51

Currency

Federal English Statutes reflect amendments current to December 12, 2016

Federal English Regulations are current to Gazette Vol. 150:24 (November 30, 2016)

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R.S.C. 1985, c. C-44, s. 226

s 226.

Currency

226.

226(1)Definition of "shareholder"

In this section, **"shareholder"** includes the heirs and personal representatives of a shareholder.

226(2)Continuation of actions

Notwithstanding the dissolution of a body corporate under this Act,

(a) a civil, criminal or administrative action or proceeding commenced by or against the body corporate before its dissolution may be continued as if the body corporate had not been dissolved;

(b) a civil, criminal or administrative action or proceeding may be brought against the body corporate within two years after its dissolution as if the body corporate had not been dissolved; and

(c) any property that would have been available to satisfy any judgment or order if the body corporate had not been dissolved remains available for such purpose.

226(3)Service

Service of a document on a corporation after its dissolution may be effected by serving the document on a person shown in the last notice filed under section 106 or 113.

226(3.1)Idem

Service of a document on a company to which the *Canada Corporations Act*, chapter C-32 of the Revised Statutes of Canada, 1970, applied that has been dissolved by subsection 261(8) of the *Canada Business Corporations Act*, chapter 33 of the Statutes of Canada, 1974-75-76 and chapter 9 of the Statutes of Canada, 1978-79, may be effected by serving the document on a person shown as a director in the last annual summary filed by the company pursuant to the *Canada Corporations Act*.

226(4)Reimbursement

Notwithstanding the dissolution of a body corporate under this Act, a shareholder to whom any of its property has been distributed is liable to any person claiming under subsection (2) to the extent of the amount received by that shareholder on such distribution, and an action to enforce such liability may be brought within two years after the date of the dissolution of the body corporate.

226(5)Representative action

A court may order an action referred to in subsection (4) to be brought against the persons who were shareholders as a class, subject to such conditions as the court thinks fit and, if the plaintiff establishes a claim, the court may refer the proceedings to a referee or other officer of the court who may

(a) add as a party to the proceedings each person who was a shareholder found by the plaintiff;

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(b) determine, subject to subsection (4), the amount that each person who was a shareholder shall contribute towards satisfaction of the plaintiff's claim; and

(c) direct payment of the amounts so determined.

Amendment History
1992, c. 1, s. 57; 2001, c. 14, ss. 112, 135 (Sched., s. 72)

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TAB 88

Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.1

s 31.1 Authentication of electronic documents

Currency

31.1Authentication of electronic documents

Any person seeking to admit an electronic document as evidence has the burden of proving its authenticity by evidence capable of supporting a finding that the electronic document is that which it is purported to be.

Amendment History

2000, c. 5, s. 56

Currency

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.2

s 31.2

Currency

31.2

31.2(1)Application of best evidence rule — electronic documents

The best evidence rule in respect of an electronic document is satisfied

(a) on proof of the integrity of the electronic documents system by or in which the electronic document was recorded or stored; or

(b) if an evidentiary presumption established under section 31.4 applies.

31.2(2)Printouts

Despite subsection (1), in the absence of evidence to the contrary, an electronic document in the form of a printout satisfies the best evidence rule if the printout has been manifestly or consistently acted on, relied on or used as a record of the information recorded or stored in the printout.

Amendment History
2000, c. 5, s. 56

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.3

s 31.3 Presumption of integrity

Currency

31.3Presumption of integrity

For the purposes of subsection 31.2(1), in the absence of evidence to the contrary, the integrity of an electronic documents system by or in which an electronic document is recorded or stored is proven

(a) by evidence capable of supporting a finding that at all material times the computer system or other similar device used by the electronic documents system was operating properly or, if it was not, the fact of its not operating properly did not affect the integrity of the electronic document and there are no other reasonable grounds to doubt the integrity of the electronic documents system;

(b) if it is established that the electronic document was recorded or stored by a party who is adverse in interest to the party seeking to introduce it; or

(c) if it is established that the electronic document was recorded or stored in the usual and ordinary course of business by a person who is not a party and who did not record or store it under the control of the party seeking to introduce it.

Amendment History

2000, c. 5, s. 56

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.4

s 31.4 Presumptions regarding secure electronic signatures

Currency

31.4Presumptions regarding secure electronic signatures

The Governor in Council may make regulations establishing evidentiary presumptions in relation to electronic documents signed with secure electronic signatures, including regulations respecting

(a) the association of secure electronic signatures with persons; and

(b) the integrity of information contained in electronic documents signed with secure electronic signatures.

Amendment History

2000, c. 5, s. 56

Currency

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.5

s 31.5 Standards may be considered

Currency

31.5Standards may be considered
For the purpose of determining under any rule of law whether an electronic document is admissible, evidence may be presented in respect of any standard, procedure, usage or practice concerning the manner in which electronic documents are to be recorded or stored, having regard to the type of business, enterprise or endeavour that used, recorded or stored the electronic document and the nature and purpose of the electronic document.

Amendment History
2000, c. 5, s. 56

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.6

s 31.6

Currency

31.6

31.6(1)Proof by affidavit

The matters referred to in subsection 31.2(2) and sections 31.3 and 31.5 and in regulations made under section 31.4 may be established by affidavit.

31.6(2)Cross-examination

A party may cross-examine a deponent of an affidavit referred to in subsection (1) that has been introduced in evidence

(a) as of right, if the deponent is an adverse party or is under the control of an adverse party; and

(b) with leave of the court, in the case of any other deponent.

Amendment History

2000, c. 5, s. 56

Currency

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.7

s 31.7 Application

Currency

31.7Application
Sections 31.1 to 31.4 do not affect any rule of law relating to the admissibility of evidence, except the rules relating to authentication and best evidence.

Amendment History
2000, c. 5, s. 56

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Documentary Evidence

R.S.C. 1985, c. C-5, s. 31.8

s 31.8 Definitions

Currency

31.8Definitions
The definitions in this section apply in sections 31.1 to 31.6.

"computer system" means a device that, or a group of interconnected or related devices one or more of which,

(a) contains computer programs or other data; and

(b) pursuant to computer programs, performs logic and control, and may perform any other function.

"data" means representations of information or of concepts, in any form.

"electronic document" means data that is recorded or stored on any medium in or by a computer system or other similar device and that can be read or perceived by a person or a computer system or other similar device. It includes a display, printout or other output of that data.

"electronic documents system" includes a computer system or other similar device by or in which data is recorded or stored and any procedures related to the recording or storage of electronic documents.

"secure electronic signature" means a secure electronic signature as defined in subsection 31(1) of the *Personal Information Protection and Electronic Documents Act.*

Amendment History
2000, c. 5, s. 56

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Canada Federal Statutes
Canada Evidence Act
Part I — (ss. 2-42)
Provincial Laws of Evidence

R.S.C. 1985, c. C-5, s. 40

s 40. How applicable

Currency

40.How applicable
In all proceedings over which Parliament has legislative authority, the laws of evidence in force in the province in which those proceedings are taken, including the laws of proof of service of any warrant, summons, subpoena or other document, subject to this Act and other Acts of Parliament, apply to those proceedings.

Currency
Federal English Statutes reflect amendments current to December 12, 2016
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Crankshaw Legislative Histories:

Crankshaw's Criminal Code of Canada, Legislative History for CRANKSHAW-HIST CEA 40

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TAB 89

Canada Federal Statutes
Canada Labour Code
Part I — Industrial Relations (ss. 3-121.5)
Division III — Acquisition and Termination of Bargaining Rights
Successor Rights and Obligations

R.S.C. 1985, c. L-2, s. 43

s 43.

Currency

43.

43(1)Mergers, etc., of trade unions

Where, by reason of a merger or amalgamation of trade unions or a transfer of jurisdiction among trade unions, a trade union succeeds another trade union that, at the time of the merger, amalgamation or transfer of jurisdiction, is a bargaining agent, the successor shall be deemed to have acquired the rights, privileges and duties of its predecessor, whether under a collective agreement or otherwise.

43(2)Board may determine questions

Where, on a merger or amalgamation of trade unions or a transfer of jurisdiction among trade unions, any question arises concerning the rights, privileges and duties of a trade union under this Part or under a collective agreement in respect of a bargaining unit or an employee therein, the Board, on application to it by a trade union affected by the merger, amalgamation or transfer of jurisdiction, shall determine what rights, privileges and duties have been acquired or are retained.

43(3)Inquiry and votes

Before determining, pursuant to subsection (2), what rights, privileges and duties of a trade union have been acquired or are retained, the Board may make such inquiry or direct that such representation votes be taken as it considers necessary.

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TAB 90

Ontario Statutes
Construction Lien Act
Part II — Trust Provisions (ss. 7-13)

R.S.O. 1990, c. C.30, s. 13

s 13.

Currency

13.
13(1)Liability for breach of trust by corporation
In addition to the persons who are otherwise liable in an action for breach of trust under this Part,

(a) every director or officer of a corporation; and

(b) any person, including an employee or agent of the corporation, who has effective control of a corporation or its relevant activities,

who assents to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to breach of trust by the corporation is liable for the breach of trust.

13(2)Effective control of corporation
The question of whether a person has effective control of a corporation or its relevant activities is one of fact and in determining this the court may disregard the form of any transaction and the separate corporate existence of any participant.

13(3)Joint and several liability
Where more than one person is found liable or has admitted liability for a particular breach of trust under this Part, those persons are jointly and severally liable.

13(4)Contribution
A person who is found liable, or who has admitted liability, for a particular breach of a trust under this Part is entitled to recover contribution from any other person also liable for the breach in such amount as will result in equal contribution by all parties liable for the breach unless the court considers such apportionment would not be fair and, in that case, the court may direct such contribution or indemnity as the court considers appropriate in the circumstances.

Currency
Ontario Current to Gazette Vol. 149:50 (December 10, 2016)

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TAB 91

B.C. Statutes
Employment Standards Act
Part 11 — Enforcement

R.S.B.C. 1996, c. 113, s. 95

s 95. Associated corporations

Currency

95.Associated corporations
If the director considers that businesses, trades or undertakings are carried on by or through more than one corporation, individual, firm, syndicate or association, or any combination of them under common control or direction,

(a) the director may treat the corporations, individuals, firms, syndicates or associations, or any combination of them, as one employer for the purposes of this Act, and

(b) if so, they are jointly and separately liable for payment of the amount stated in a determination, a settlement agreement or an order of the tribunal, and this Act applies to the recovery of that amount from any or all of them.

Amendment History
2002, c. 42, s. 53; 2003, c. 65, s. 9

Currency
British Columbia Current to B.C. Reg. 260/2016 (November 1, 2016)

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B.C. Statutes
Employment Standards Act
Part 11 — Enforcement

R.S.B.C. 1996, c. 113, s. 96

s 96. Corporate officer's liability for unpaid wages

Currency

96.Corporate officer's liability for unpaid wages
96(1) A person who was a director or officer of a corporation at the time wages of an employee of the corporation were earned or should have been paid is personally liable for up to 2 months' unpaid wages for each employee.

96(2) Despite subsection (1), a person who was a director or an officer of a corporation is not personally liable for

(a) any liability to an employee under section 63, termination pay or money payable in respect of individual or group terminations, if the corporation is in receivership,

(b) any liability to an employee for wages, if the corporation is subject to action under section 427 of the *Bank Act* (Canada) or to a proceeding under an insolvency Act,

(c) vacation pay that becomes payable after the director or officer ceases to hold office, or

(d) money that remains in an employee's time bank after the director or officer ceases to hold office.

96(2.1) If a corporation that is a talent agency has received wages from an employer on behalf of an employee and fails to pay those wages, less any fees allowed under the regulations, to the employee within the time required under the regulations,

(a) a person who was a director or officer of the corporation at the time the wages were received is personally liable for the amount received by the corporation from the employer, less any fees allowed under the regulations, and

(b) that amount is considered for the purposes of subsection (3) to be unpaid wages.

96(3) This Act applies to the recovery of the unpaid wages from a person liable for them under subsection (1) or (2.1).

96(4) In this section, **"director or officer of a corporation"** includes a director or officer of a corporation, firm, syndicate or association that the director treats as one employer under section 95.

Amendment History
1999, c. 13, s. 7; 2002, c. 42, s. 54; 2003, c. 65, s. 10

Currency
British Columbia Current to B.C. Reg. 260/2016 (November 1, 2016)

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TAB 92

B.C. Statutes
Environmental Management Act
Part 10 — General
Division 1 — Offences and Penalties

S.B.C. 2003, c. 53, s. 121

s 121. Offence by a corporation

Currency

121.Offence by a corporation
121(1) If a corporation commits an offence under this Act, an employee, officer, director or agent of the corporation who authorized, permitted or acquiesced in the offence commits the offence whether or not the corporation is convicted.

121(2) In a prosecution for an offence under or arising out of a contravention of section 9(1) *[hazardous waste storage and disposal]* or 10(1) or (3) *[transportation of hazardous waste]*, or of a regulation made with respect to hazardous waste, it is sufficient proof of the offence to establish that it was committed by an employee or agent of the accused whether or not the employee or agent is identified or has been prosecuted for the offence, unless the accused establishes that the offence was committed without the accused's knowledge or consent or that the accused exercised all due diligence to prevent its commission.

Currency
British Columbia Current to B.C. Reg. 260/2016 (November 1, 2016)

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TAB 93

R.S.O. 1990, c. E.19, s. 99

s 99.

Currency

99.
99(1)Definition
In this section,

"loss or damage" includes personal injury, loss of life, loss of use or enjoyment of property and pecuniary loss, including loss of income.

99(2)Right to Compensation
Her Majesty in right of Ontario or in right of Canada or any other person has the right to compensation,

(a) for loss or damage incurred as a direct result of,

(i) the spill of a pollutant that causes or is likely to cause an adverse effect,

(ii) the exercise of any authority under subsection 100(1) or the carrying out of or attempting to carry out a duty imposed or an order or direction made under this Part, or

(iii) neglect or default in carrying out a duty imposed or an order or direction made under this Part;

(b) for all reasonable cost and expense incurred in respect of carrying out or attempting to carry out an order or direction under this Part,

from the owner of the pollutant and the person having control of the pollutant.

99(3)Exception
An owner of a pollutant or a person having control of a pollutant is not liable under subsection (2) if they establish that they took all reasonable steps to prevent the spill of the pollutant or if they establish that the spill of the pollutant was wholly caused by,

(a) an act of war, civil war, insurrection, an act of terrorism or an act of hostility by the government of a foreign country;

(b) a natural phenomenon of an exceptional, inevitable and irresistible character; or

(c) an act or omission with intent to cause harm by a person other than a person for whose wrongful act or omission the owner of the pollutant or the person having control of the pollutant is by law responsible,

or any combination thereof.

99(4)Qualification
Subsection (3) does not relieve the owner of the pollutant or the person having control of the pollutant,

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(a) from liability for loss or damage that is a direct result of neglect or default of the owner of the pollutant or the person having control of the pollutant in carrying out a duty imposed or an order or direction made under this Part; or

(b) from liability, under clause (2)(a), for cost and expense incurred or, under clause (2)(b), for all reasonable cost and expense incurred,

(i) to do everything practicable to prevent, eliminate and ameliorate the adverse effect; or

(ii) to do everything practicable to restore the natural environment,

or both.

99(5)Enforcement of Right
The right to compensation under subsection (2) may be enforced by action in a court of competent jurisdiction.

99(6)Liability
Liability under subsection (2) does not depend upon fault or negligence.

99(7)Contribution
In an action under this section,

(a) where the plaintiff is an owner of the pollutant or a person having control of the pollutant, the court shall determine the degree, if any, in which the plaintiff would be liable to make contribution or indemnification under subsection (8) if the plaintiff were a defendant; and

(b) where the plaintiff is not an owner or a person having control referred to in clause (a), the court shall determine the degree, if any, in which the plaintiff caused or contributed to the loss, damage, cost or expense by fault or negligence,

and the court shall reduce the compensation by the degree, if any, so determined.

99(8)Extent of Liability
Where two or more persons are liable to pay compensation under this section, they are jointly and severally liable to the person suffering the loss, damage, cost or expense but as between themselves, in the absence of an express or implied contract, each is liable to make contribution to and indemnify the other in accordance with the following principles:

1. Where two or more persons are liable to pay compensation under this section and one or more of them caused or contributed to the loss, damage, cost or expense by fault or negligence, such one or more of them shall make contribution to and indemnify,

i. where one person is found at fault or negligent, any other person liable to pay compensation under this section, and

ii. where two or more persons are found at fault or negligent, each other and any other person liable to pay compensation under this section in the degree in which each of such two or more persons caused or contributed to the loss, damage, cost or expense by fault or negligence.

2. For the purpose of subparagraph ii of paragraph 1, if it is not practicable to determine the respective degrees in which the fault or negligence of two or more persons liable to pay compensation under this section caused or contributed to the loss, damage, cost or expense, such two or more persons shall be deemed to be equally at fault or negligent.

> 3. Where no person liable to pay compensation under this section caused or contributed to the loss, damage, cost or expense by fault or negligence, each of the persons liable to pay compensation is liable to make contribution to and indemnify each other in such degree as is determined to be just and equitable in the circumstances.

99(9)Enforcement of Contribution
The right to contribution or indemnification under subsection (8) may be enforced by action in a court of competent jurisdiction.

99(10)Adding Parties
Wherever it appears that a person not already a party to an action under this section may be liable in respect of the loss, damage, cost or expense for which compensation is claimed, the person may be added as a party defendant to the action upon such terms as are considered just or may be made a third party to the action in the manner prescribed by the rules of practice for adding third parties.

99(11)Settlement and Recovery Between Persons Liable
A person liable to pay compensation under this section may recover contribution or indemnity from any other person liable to pay compensation under this section in respect of the loss, damage, cost or expense for which the compensation is claimed by settling with the person suffering the loss, damage, cost or expense and continuing the action or commencing an action against such other person.

99(12)Amount of Settlement
A person who has settled a claim and continued or commenced an action as mentioned in subsection (11) must satisfy the court that the amount of the settlement was reasonable, and, if the court finds the amount was excessive, the court may fix the amount at which the claim should have been settled.

99(13) [Repealed 2002, c. 24, Sched. B, s. 25, item 8.]

[Note: The Limitations Act, 2002*, S.O. 2002, c. 24, Schedule B, s. 25, item 8 (in force January 1, 2004) repealed the limitation periods prescribed by s. 99(13). Reference should be made to ss. 1, 4, 15 and 17 of the* Limitations Act, 2002 *for the relevant new limitation periods and related definitions, and to s. 24 of that Act for the applicable transitional rules. Immediately before its repeal, s. 99(13) read as follows:*

> *(13) Limitation for Actions for Compensation*
> *No person is liable to an action for compensation under this section unless the action is commenced within two years from,*
>
> > *(a) where the person commencing the action incurred loss or damage as a result of the spill of a pollutant, the date when the person knew or ought to have known of the loss or damage;*
> >
> > *(b) where the person commencing the action incurred loss or damage as a result of carrying out or attempting to carry out or neglect or default in carrying out a duty imposed or an order or direction made under this Part, the date when the person knew or ought to have known of the loss or damage; or*
> >
> > *(c) where the person commencing the action incurred cost and expense in respect of carrying out or attempting to carry out an order or direction made under this Part, the date when the person incurred the cost and expense.*

99(14) [Repealed 2002, c. 24, Sched. B, s. 25, item 8.]

[Note: The Limitations Act, 2002*, S.O. 2002, c. 24, Schedule B, s. 25, item 8 (in force January 1, 2004) repealed the limitation periods prescribed by s. 99(14). Reference should be made to ss. 1, 4, 15 and 17 of the* Limitations Act, 2002 *for the relevant new limitation periods and related definitions, and to s. 24 of that Act for the applicable transitional rules. Immediately before its repeal, s. 99(14) read as follows:*

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(14) Limitation for Actions for Contribution or Indemnity
Where, within the period of time prescribed by subsection (13), an action for compensation is commenced against a person liable to pay compensation under this section or a person liable to pay compensation under this section settles a claim for compensation with a person who has suffered loss, damage, cost or expense, no proceeding for contribution or indemnity against another person liable to pay compensation under this section is defeated by the operation of any Act limiting the time for the commencement of action against such other person if,

(a) the proceeding is commenced within one year of the date of the judgment in the action or the settlement, as the case may be; and

(b) there has been compliance with any Act requiring notice of claim against such other person.

Amendment History
2002, c. 24, Sched. B, s. 25, item 8

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Ontario Current to Gazette Vol. 149:50 (December 10, 2016)

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TAB 94

Canada Federal Statutes
Excise Tax Act (GST/HST Portions)
IX — Goods and Services Tax
Division VIII — Administration and Enforcement [ss. 275-335]
Subdivision e — Collection [ss. 313-325]

R.S.C. 1985, c. E-15, s. 323

s 323.

Currency

323.

323(1)Liability of directors

If a corporation fails to remit an amount of net tax as required under subsection 228(2) or (2.3) or to pay an amount as required under section 230.1 that was paid to, or was applied to the liability of, the corporation as a net tax refund, the directors of the corporation at the time the corporation was required to remit or pay, as the case may be, the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay the amount and any interest on, or penalties relating to, the amount.

323(2)Limitations

A director of a corporation is not liable under subsection (1) unless

(a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 316 and execution for that amount has been returned unsatisfied in whole or in part;

(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in subsection (1) has been proved within six months after the date of the assignment or bankruptcy order.

323(3)Diligence

A director of a corporation is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

323(4)Assessment

The Minister may assess any person for any amount payable by the person under this section and, where the Minister sends a notice of assessment, sections 296 to 311 apply, with such modifications as the circumstances require.

323(5)Time limit

An assessment under subsection (4) of any amount payable by a person who is a director of a corporation shall not be made more than two years after the person last ceased to be a director of the corporation.

323(6)Amount recoverable

Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

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323(7)Preference

Where a director of a corporation pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had the amount not been so paid and, where a certificate that relates to the amount has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is empowered to make.

323(8)Contribution

A director who satisfies a claim under this section is entitled to contribution from the other directors who were liable for the claim.

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Federal English Statutes reflect amendments current to December 12, 2016
Federal English Regulations are current to Gazette Vol. 150:24 (November 30, 2016)

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TAB 95

Canada Federal Statutes
Income Tax Act
Part XV — (ss. 220-244) Administration and Enforcement
(ss. 222-229.1) Collection

R.S.C. 1985, c. 1 (5th Supp.), s. 227.1

s 227.1

Currency

227.1

227.1(1)Liability of directors for failure to deduct

Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable, together with the corporation, to pay that amount and any interest or penalties relating to it.

227.1(2)Limitations on liability

A director is not liable under subsection (1), unless

(a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court under section 223 and execution for that amount has been returned unsatisfied in whole or in part;

(b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or

(c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or bankruptcy order.

227.1(3)Idem [due diligence defence]

A director is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.

227.1(4)Limitation period

No action or proceedings to recover any amount payable by a director of a corporation under subsection (1) shall be commenced more than two years after the director last ceased to be a director of that corporation.

227.1(5)Amount recoverable

Where execution referred to in paragraph (2)(a) has issued, the amount recoverable from a director is the amount remaining unsatisfied after execution.

227.1(6)Preference

Where a director pays an amount in respect of a corporation's liability referred to in subsection (1) that is proved in liquidation, dissolution or bankruptcy proceedings, the director is entitled to any preference that Her Majesty in right of Canada would have been entitled to had that amount not been so paid and, where a certificate that relates to that amount

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has been registered, the director is entitled to an assignment of the certificate to the extent of the director's payment, which assignment the Minister is hereby empowered to make.

227.1(7)Contribution

A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim.

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TAB 96

B.C. Statutes
Labour Relations Code
Part 3 — Acquisition and Termination of Bargaining Rights (ss. 18-44)
Division 3 — Successor Rights and Obligations

R.S.B.C. 1996, c. 244, s. 35

s 35. Successor rights and obligations

Currency

35.Successor rights and obligations
35(1) If a business or a part of it is sold, leased, transferred or otherwise disposed of, the purchaser, lessee or transferee is bound by all proceedings under this Code before the date of the disposition and the proceedings must continue as if no change had occurred.

35(2) If a collective agreement is in force, it continues to bind the purchaser, lessee or transferee to the same extent as if it had been signed by the purchaser, lessee or transferee, as the case may be.

35(3) If a question arises under this section, the board, on application by any person, must determine what rights, privileges and duties have been acquired or are retained.

35(4) For the purposes of this section, the board may make inquiries or direct that representation votes be taken as it considers necessary or advisable.

35(5) The board, having made an inquiry or directed a vote under this section, may

(a) determine whether the employees constitute one or more units appropriate for collective bargaining,

(b) determine which trade union is to be the bargaining agent for the employees in each unit,

(c) amend, to the extent it considers necessary or advisable, a certificate issued to a trade union or the description of a unit contained in a collective agreement,

(d) modify or restrict the operation or effect of a provision of a collective agreement in order to define the seniority rights under it of employees affected by the sale, lease, transfer or other disposition, and

(e) give directions the board considers necessary or advisable as to the interpretation and application of a collective agreement affecting the employees in a unit determined under this section to be appropriate for collective bargaining.

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B.C. Statutes
Labour Relations Code
Part 3 — Acquisition and Termination of Bargaining Rights (ss. 18-44)
Division 3 — Successor Rights and Obligations

R.S.B.C. 1996, c. 244, s. 38

s 38. Several businesses treated as one employer

Currency

38.Several businesses treated as one employer
If in the board's opinion associated or related activities or businesses are carried on by or through more than one corporation, individual, firm, syndicate or association, or a combination of them under common control or direction, the board may treat them as constituting one employer for the purposes of this Code and grant such relief, by way of declaration or otherwise, as the board considers appropriate.

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TAB 97

B.C. Rules
B.C. Reg. 168/2009 — Supreme Court Civil Rules
Part 1 — Interpretation
Rule 1-3 — Object of Rules

B.C. Reg. 168/2009, s. 1-3(1)

s 1-3(1) Object

Currency

1-3(1)Object
The object of these *Supreme Court Civil Rules* is to secure the just, speedy and inexpensive determination of every proceeding on its merits.

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B.C. Rules
B.C. Reg. 168/2009 — Supreme Court Civil Rules
Part 1 — Interpretation
Rule 1-3 — Object of Rules

B.C. Reg. 168/2009, s. 1-3(2)

s 1-3(2) Proportionality

Currency

1-3(2)Proportionality

Securing the just, speedy and inexpensive determination of a proceeding on its merits includes, so far as is practicable, conducting the proceeding in ways that are proportionate to

(a) the amount involved in the proceeding,

(b) the importance of the issues in dispute, and

(c) the complexity of the proceeding.

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B.C. Rules
B.C. Reg. 168/2009 — Supreme Court Civil Rules
Part 9 — Pre-Trial Resolution Procedures
Rule 9-7 — Summary Trial

B.C. Reg. 168/2009, s. 9-7(1)

s 9-7(1) Definition

Currency

9-7(1)Definition
In this rule, **"summary trial application"** means an application referred to in subrule (2).

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B.C. Reg. 168/2009, s. 9-7(2)

s 9-7(2) Application

Currency

9-7(2)Application
A party may apply to the court for judgment under this rule, either on an issue or generally, in any of the following:

(a) an action in which a response to civil claim has been filed;

(b) a proceeding that has been transferred to the trial list under Rule 22-1(7)(d);

(c) a third party proceeding in which a response to third party notice has been filed;

(d) an action by way of counterclaim in which a response to counterclaim has been filed.

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B.C. Reg. 168/2009, s. 9-7(3)

s 9-7(3) When application must be heard

Currency

9-7(3)When application must be heard
A summary trial application must be heard at least 42 days before the scheduled trial date.

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B.C. Reg. 168/2009, s. 9-7(4)

s 9-7(4) Setting application for hearing

Currency

9-7(4)Setting application for hearing

Unless the court otherwise orders, a summary trial application must be set for hearing in accordance with Rule 8-1.

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B.C. Reg. 168/2009, s. 9-7(5)

s 9-7(5) Evidence on application

Currency

9-7(5)Evidence on application

Unless the court otherwise orders, on a summary trial application, the applicant and each other party of record may tender evidence by any or all of the following:

(a) affidavit;

(b) an answer, or part of an answer, to interrogatories;

(c) any part of the evidence taken on an examination for discovery;

(d) an admission under Rule 7-7;

(e) a report setting out the opinion of an expert, if

(i) the report conforms with Rule 11-6(1), or

(ii) the court orders that the report is admissible even though it does not conform with Rule 11-6(1).

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B.C. Reg. 168/2009, s. 9-7(6)

s 9-7(6) Application of Rule 12-5

Currency

9-7(6)Application of Rule 12-5
Rule 12-5(46), (49), (50), (51), (56) to (58) applies to subrule (5) of this rule.

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B.C. Reg. 168/2009, s. 9-7(7)

s 9-7(7) Application of Rules 11-6 and 11-7

Currency

9-7(7)Application of Rules 11-6 and 11-7
Rule 11-6(2) applies to a summary trial application.

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B.C. Reg. 168/2009, s. 9-7(8)

s 9-7(8) Filings with application

Currency

9-7(8)Filings with application
A party who applies for judgment under subrule (2)

(a) must serve, with the notice of application and the other documents referred to in Rule 8-1(3), every expert report, not already filed, on which the party will rely in support of the application, and

(b) must not serve any further affidavits, expert reports or notices except

(i) to tender evidence that would, at a trial, be admitted as rebuttal evidence,

(ii) to respond to a notice of application filed and served by another party of record, or

(iii) with leave of the court.

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B.C. Reg. 168/2009, s. 9-7(9)

s 9-7(9) Notice of evidence to be used on application

Currency

9-7(9)Notice of evidence to be used on application
If a party intends, on a summary trial application, to rely on

(a) evidence taken on an examination for discovery,

(b) answers to interrogatories, or

(c) admissions,

the party must give notice of that fact in accordance with subrule (10).

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B.C. Reg. 168/2009, s. 9-7(10)

s 9-7(10) Giving notice

Currency

9-7(10)Giving notice
Notice under subrule (9) must be given

(a) by an applicant, in accordance with Rule 8-1(7) and (8), and

(b) by a party who is not an applicant, in accordance with Rule 8-1(9).

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B.C. Reg. 168/2009, s. 9-7(11)

s 9-7(11) Adjournment or dismissal

Currency

9-7(11)Adjournment or dismissal

On an application heard before or at the same time as the hearing of a summary trial application, the court may

(a) adjourn the summary trial application, or

(b) dismiss the summary trial application on the ground that

(i) the issues raised by the summary trial application are not suitable for disposition under this rule, or

(ii) the summary trial application will not assist the efficient resolution of the proceeding.

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B.C. Reg. 168/2009, s. 9-7(12)

s 9-7(12) Preliminary orders

Currency

9-7(12)Preliminary orders
On or before the hearing of a summary trial application, the court may order that

(a) a party file and serve, within a fixed time, any of the following on which the party intends to rely in support of the application:

(i) an affidavit;

(ii) a notice referred to in subrule (9),

(b) the person who swore or affirmed an affidavit, or an expert whose report is relied on, attend for cross-examination, either before the court or before another person as the court directs,

(c) cross-examinations on affidavits be completed within a fixed time,

(d) no further evidence be tendered on the application after a fixed time, or

(e) a party file and serve a brief, with such contents as the court may order, within a fixed time.

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B.C. Reg. 168/2009, s. 9-7(13)

s 9-7(13) Ancillary or preliminary orders may be made at or before application

Currency

9-7(13)Ancillary or preliminary orders may be made at or before application
An order under subrule (11) or (12) may be made by a judge or by a master, and may be made before or at the same time as a summary trial application.

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B.C. Reg. 168/2009, s. 9-7(14)

s 9-7(14) Judge not seized of application

Currency

9-7(14)Judge not seized of application

A judge who makes an order under subrule (11) or (12) in relation to a summary trial application is not seized of the summary trial application unless the judge otherwise orders.

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B.C. Reg. 168/2009, s. 9-7(15)

s 9-7(15) Judgment

Currency

9-7(15)Judgment
On the hearing of a summary trial application, the court may

(a) grant judgment in favour of any party, either on an issue or generally, unless

(i) the court is unable, on the whole of the evidence before the court on the application, to find the facts necessary to decide the issues of fact or law, or

(ii) the court is of the opinion that it would be unjust to decide the issues on the application,

(b) impose terms respecting enforcement of the judgment, including a stay of execution, and

(c) award costs.

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B.C. Reg. 168/2009, s. 9-7(16)

s 9-7(16) No further application without leave

Currency

9-7(16)No further application without leave

If the court does not grant judgment under subrule (15), the applicant may not apply again under subrule (2) without leave of the court.

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B.C. Rules
B.C. Reg. 168/2009 — Supreme Court Civil Rules
Part 9 — Pre-Trial Resolution Procedures
Rule 9-7 — Summary Trial

B.C. Reg. 168/2009, s. 9-7(17)

s 9-7(17) Orders

Currency

9-7(17)Orders
If the court is unable to grant judgment under subrule (15) and considers that the proceeding ought to be expedited, the court may order the trial of a proceeding generally or on an issue and may

(a) order that the parties attend a case planning conference,

(b) make any order that may be made under Rule 5-3(1), or

(c) make any other order the court considers will further the object of these *Supreme Court Civil Rules*.

Currency
British Columbia Current to B.C. Reg. 240/2016 (October 18, 2016)

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B.C. Rules
B.C. Reg. 168/2009 — Supreme Court Civil Rules
Part 9 — Pre-Trial Resolution Procedures
Rule 9-7 — Summary Trial

B.C. Reg. 168/2009, s. 9-7(18)

s 9-7(18) Right to vary or set aside order

Currency

9-7(18)Right to vary or set aside order
A court may, before or at trial, vary or set aside an order made under subrules (12) and (17) of this rule.

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British Columbia Current to B.C. Reg. 240/2016 (October 18, 2016)

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B.C. Rules
B.C. Reg. 168/2009 — Supreme Court Civil Rules
Part 9 — Pre-Trial Resolution Procedures
Rule 9-7 — Summary Trial

B.C. Reg. 168/2009, s. 9-7(19)

s 9-7(19) Order if jury notice filed

Currency

9-7(19)Order if jury notice filed

A party may apply to the court for judgment under subrule (2) even though a party may have filed a notice under Rule 12-6(3) requiring that the trial of the action be heard with a jury.

Amendment History

B.C. Reg. 119/2010 (Sched. A), s. 23; 241/2010 (Sched. A), s. 2

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B.C. Rules
B.C. Reg. 168/2009 — Supreme Court Civil Rules
Part 22 — General
Rule 22-2 — Affidavits

B.C. Reg. 168/2009, s. 22-2(12)

s 22-2(12) Limitation on contents of affidavit

Currency

22-2(12)Limitation on contents of affidavit

Subject to subrule (13), an affidavit must state only what a person swearing or affirming the affidavit would be permitted to state in evidence at a trial.

Currency

British Columbia Current to B.C. Reg. 240/2016 (October 18, 2016)

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TAB 98

United States Code Annotated
Title 29. Labor
Chapter 18. Employee Retirement Income Security Program (Refs & Annos)
SuperBrowse Subchapter III. Plan Termination Insurance (Refs & Annos)
SuperBrowse Subtitle B. Coverage (Refs & Annos)

29 U.S.C.A. § 1321

§ 1321. Coverage

Currentness

(a) Plans covered

Except as provided in subsection (b) of this section, this subchapter applies to any plan (including a successor plan) which, for a plan year--

(1) is an employee pension benefit plan (as defined in paragraph (2) of section 1002 of this title) established or maintained--

(A) by an employer engaged in commerce or in any industry or activity affecting commerce, or

(B) by any employee organization, or organization representing employees, engaged in commerce or in any industry or activity affecting commerce, or

(C) by both,

which has, in practice, met the requirements of part I of subchapter D of chapter 1 of Title 26 (as in effect for the preceding 5 plan years of the plan) applicable to the plans described in paragraph (2) for the preceding 5 plan years; or

(2) is, or has been determined by the Secretary of the Treasury to be, a plan described in section 401(a) of Title 26, or which meets, or has been determined by the Secretary of the Treasury to meet, the requirements of section 404(a)(2) of Title 26.

For purposes of this subchapter, a successor plan is considered to be a continuation of a predecessor plan. For this purpose, unless otherwise specifically indicated in this subchapter, a successor plan is a plan which covers a group of employees which includes substantially the same employees as a previously established plan, and provides substantially the same benefits as that plan provided. ...

TAB 99

United States Code Annotated
Title 29. Labor
Chapter 18. Employee Retirement Income Security Program (Refs & Annos)
SuperBrowse Subchapter III. Plan Termination Insurance (Refs & Annos)
SuperBrowse Subtitle B. Coverage (Refs & Annos)

29 U.S.C.A. § 1321

§ 1321. Coverage

Currentness

(b) Plans not covered

This section does not apply to any plan--

...

> **(7)** which is established and maintained outside of the United States primarily for the benefit of individuals substantially all of whom are nonresident aliens...

TAB 100

United States Code Annotated
Title 29. Labor
Chapter 18. Employee Retirement Income Security Program (Refs & Annos)
Subchapter III. Plan Termination Insurance (Refs & Annos)
Subtitle E. Special Provisions for Multiemployer Plans (Refs & Annos)
Part 1. Employer Withdrawals (Refs & Annos)

29 U.S.C.A. § 1383

§ 1383. Complete withdrawal

Currentness

(a) Determinative factors

For purposes of this part, a complete withdrawal from a multiemployer plan occurs when an employer--

(1) permanently ceases to have an obligation to contribute under the plan, or

(2) permanently ceases all covered operations under the plan.

(b) Building and construction industry

(1) Notwithstanding subsection (a) of this section, in the case of an employer that has an obligation to contribute under a plan for work performed in the building and construction industry, a complete withdrawal occurs only as described in paragraph (2), if--

(A) substantially all the employees with respect to whom the employer has an obligation to contribute under the plan perform work in the building and construction industry, and

(B) the plan--

(i) primarily covers employees in the building and construction industry, or

(ii) is amended to provide that this subsection applies to employers described in this paragraph.

(2) A withdrawal occurs under this paragraph if--

(A) an employer ceases to have an obligation to contribute under the plan, and

(B) the employer--

(i) continues to perform work in the jurisdiction of the collective bargaining agreement of the type for which contributions were previously required, or

(ii) resumes such work within 5 years after the date on which the obligation to contribute under the plan ceases, and does not renew the obligation at the time of the resumption.

(3) In the case of a plan terminated by mass withdrawal (within the meaning of section 1341a(a)(2) of this title), paragraph (2) shall be applied by substituting "3 years" for "5 years" in subparagraph (B)(ii).

(c) Entertainment industry

(1) Notwithstanding subsection (a) of this section, in the case of an employer that has an obligation to contribute under a plan for work performed in the entertainment industry, primarily on a temporary or project-by-project basis, if the plan primarily covers employees in the entertainment industry, a complete withdrawal occurs only as described in subsection (b)(2) of this section applied by substituting "plan" for "collective bargaining agreement" in subparagraph (B)(i) thereof.

(2) For purposes of this subsection, the term "entertainment industry" means--

(A) theater, motion picture (except to the extent provided in regulations prescribed by the corporation), radio, television, sound or visual recording, music, and dance, and

(B) such other entertainment activities as the corporation may determine to be appropriate.

(3) The corporation may by regulation exclude a group or class of employers described in the preceding sentence from the application of this subsection if the corporation determines that such exclusion is necessary--

(A) to protect the interest of the plan's participants and beneficiaries, or

(B) to prevent a significant risk of loss to the corporation with respect to the plan.

(4) A plan may be amended to provide that this subsection shall not apply to a group or class of employers under the plan.

(d) Other determinative factors

(1) Notwithstanding subsection (a) of this section, in the case of an employer who--

(A) has an obligation to contribute under a plan described in paragraph (2) primarily for work described in such paragraph, and

(B) does not continue to perform work within the jurisdiction of the plan,

a complete withdrawal occurs only as described in paragraph (3).

(2) A plan is described in this paragraph if substantially all of the contributions required under the plan are made by employers primarily engaged in the long and short haul trucking industry, the household goods moving industry, or the public warehousing industry.

(3) A withdrawal occurs under this paragraph if--

(A) an employer permanently ceases to have an obligation to contribute under the plan or permanently ceases all covered operations under the plan, and

(B) either--

(i) the corporation determines that the plan has suffered substantial damage to its contribution base as a result of such cessation, or

(ii) the employer fails to furnish a bond issued by a corporate surety company that is an acceptable surety for purposes of section 1112 of this title, or an amount held in escrow by a bank or similar financial institution satisfactory to the plan, in an amount equal to 50 percent of the withdrawal liability of the employer.

(4) If, after an employer furnishes a bond or escrow to a plan under paragraph (3)(B)(ii), the corporation determines that the cessation of the employer's obligation to contribute under the plan (considered together with any cessations by other employers), or cessation of covered operations under the plan, has resulted in substantial damage to the contribution base of the plan, the employer shall be treated as having withdrawn from the plan on the date on which the obligation to contribute or covered operations ceased, and such bond or escrow shall be paid to the plan. The corporation shall not make a determination under this paragraph more than 60 months after the date on which such obligation to contribute or covered operations ceased.

(5) If the corporation determines that the employer has no further liability under the plan either--

(A) because it determines that the contribution base of the plan has not suffered substantial damage as a result of the cessation of the employer's obligation to contribute or cessation of covered operations (considered together with any cessation of contribution obligation, or of covered operations, with respect to other employers), or

(B) because it may not make a determination under paragraph (4) because of the last sentence thereof, then the bond shall be cancelled or the escrow refunded.

(6) Nothing in this subsection shall be construed as a limitation on the amount of the withdrawal liability of any employer.

(e) Date of complete withdrawal

For purposes of this part, the date of a complete withdrawal is the date of the cessation of the obligation to contribute or the cessation of covered operations.

(f) Special liability withdrawal rules for industries other than construction and entertainment industries; procedures applicable to amend plans

(1) The corporation may prescribe regulations under which plans in industries other than the construction or entertainment industries may be amended to provide for special withdrawal liability rules similar to the rules described in subsections (b) and (c) of this section.

(2) Regulations under paragraph (1) shall permit use of special withdrawal liability rules--

(A) only in industries (or portions thereof) in which, as determined by the corporation, the characteristics that would make use of such rules appropriate are clearly shown, and

(B) only if the corporation determines, in each instance in which special withdrawal liability rules are permitted, that use of such rules will not pose a significant risk to the corporation under this subchapter.

CREDIT(S)

(Pub.L. 93-406, Title IV, § 4203, as added Pub.L. 96-364, Title I, § 104(2), Sept. 26, 1980, 94 Stat. 1218.)

Notes of Decisions (50)

29 U.S.C.A. § 1383, 29 USCA § 1383
Current through P.L. 114-254. Also includes P.L. 114-256.

End of Document

TAB 101

United States Code Annotated
Title 29. Labor
Chapter 18. Employee Retirement Income Security Program (Refs & Annos)
Subchapter III. Plan Termination Insurance (Refs & Annos)
SuperBrowse Subtitle E. Special Provisions for Multiemployer Plans (Refs & Annos)
SuperBrowse Part 1. Employer Withdrawals (Refs & Annos)

29 U.S.C.A. § 1392

§ 1392. Obligation to contribute

Currentness

...

(c) Transactions to evade or avoid liability

If a principal purpose of any transaction is to evade or avoid liability under this part, this part shall be applied (and liability shall be determined and collected) without regard to such transaction.

...

TAB 102

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were not subject to the jurisdiction of the English courts. If the bondholders had sued in Greece, the Greek courts would have applied the moratorium legislation.

2–032 In 1953, however, a Greek law provided for the amalgamation of the National Bank of Greece and a third Greek bank, the Bank of Athens. The new bank was called the National Bank of Greece and Athens. The Greek law provided that the new bank was the universal successor to all the assets and liabilities of the old banks. This meant that the National Bank of Greece and Athens was liable on the bonds, though, of course, the moratorium legislation prevented any action being brought against it in Greece. However, the Bank of Athens had been carrying on business in England and the new amalgamated bank continued to do so. Consequently, it was subject to the jurisdiction of the English courts, and a bondholder, Metliss, brought action in England claiming that it was liable under the guarantee. In *National Bank of Greece and Athens v Metliss*[52] the House of Lords held in favour of Metliss. The moratorium legislation was held to be inapplicable since it purported to alter obligations under a contract and was therefore to be characterised as contractual. Consequently, it could not affect a contract governed by English law.

2–033 Four days after the judgment at first instance was given, the Greek government passed a new law amending the law under which the banks were amalgamated. The new law provided that the amalgamated bank would be the universal successor to all the rights and obligations of the old banks, except obligations, whether as principal or guarantor, under bonds payable in foreign currency. The National Bank of Greece and Athens, which subsequently changed its name to the National Bank of Greece, immediately stopped making payments under the bonds. Another bondholder, Adams, brought new proceedings in the English courts. Did the new law relieve the National Bank of Greece from its liability under the bonds? This depended on how it was characterised. There can be no doubt that the new law was intended by those responsible for its enactment to be characterised as relating to the amalgamation of the banks. If this characterisation had been adopted by the English courts, they would have been obliged to hold that it was applicable in the case before them and that it gave a defence to the banks. The House of Lords, however, rejected this approach and gave judgment for Adams.

2–034 The whole point of the second Greek law was to force the English courts to apply the moratorium rule by re-enacting it as part of the amalgamation legislation. The House of Lords, however, refused to be taken in by this: they took the view that if the effect of the law was to discharge or alter a contractual right, it had to be regarded as contractual, whatever label might be attached to it by its author.[53] The purpose of the Greek law was to relieve the new bank of liability under the bonds and this purpose was not affected by the attempt of the Greek legislator to disguise it as something else.[54]

2–035 This case shows the undesirability of characterising rules of foreign law according to the legal system to which they belong. Attempts by foreign legislatures to force English courts to apply particular rules of law will, of

[52] [1958] A.C. 509.

[53] [1961] A.C. 255, at p.274, *per* Viscount Simonds.

[54] See also at p.283, *per* Lord Reid: "... we must look at the substance and effect of a foreign law ... "

course, be rare. But even when there is no deliberate manipulation, there is no reason why the English court should allow foreign law to decide whether a particular rule should be applied in the case before it.

It is apparent that whenever an issue of characterisation arises, the court is required to assess the arguments on their individual merits in the particular context, and will endeavour to avoid undue generalisation. The point can be made by reference to two recent decisions on legislative acts done in relation to contractual debts. In *Wight v Eckhardt Marine GmbH*,[55] the Privy Council characterised Bangladeshi statutory rules which provided for the restructuring of the business of an insolvent bank, and which had the effect of extinguishing claims against that bank and creating new claims against a new bank, as relating to the discharge of debts rather than the confiscation of property. They therefore concluded that the debt had been discharged by an act done under its proper law, and that it was not available for admission to proof in the insolvency. By contrast, in *Société Eram Shipping Co Ltd v Hong Kong and Shanghai Banking Corp Ltd*,[56] where an application was made to garnish, and thereby to discharge, a debt which was governed by the law of Hong Kong, the House of Lords held that the English statutory procedure for garnishment[57] of debts could not be applied to a debt owed by a Hong Kong debtor. Lord Hoffmann, in particular, expressed the view[58] that the compulsory discharge of debts by garnishment was akin to the confiscation of property and so was properly a matter for the *lex situs* rather than the *lex contractus*. 2–036

In *Through Transport Mutual Assurance Association (Eurasia) Ltd v New India Assurance Co Ltd*[59] the court characterised a direct claim before the Finnish courts and founded on a Finnish statute, brought by the victim of a tort against the liability insurer of the insured person who had caused loss, as contractual in nature, and therefore as a claim which fell within the scope of a contractual obligation to submit claims under the insurance to arbitration. It is unclear whether the construction of a contractual agreement to arbitrate raised a question of characterisation properly so called,[60] but to the extent that it did the court reached its conclusion without being constrained by the view of the matter which would have been taken by a Finnish court.[61]

Equitable claims. It will be apparent from what has been said that there may well be a lack of exact correspondence between the internal divisions of English domestic law and those of the conflict of laws. One area in which the problem of characterisation may be seen to be particularly acute is when an 2–037

[55] [2003] UKPC 37, [2004] 1 A.C. 147.

[56] [2003] UKHL 30, [2004] 1 A.C. 260.

[57] Now known as the Third Party Debt Order procedure: CPR Pt 72, and discussed further below, Ch.24.

[58] At [54].

[59] [2004] EWCA Civ 1598, [2005] 1 Lloyd's Rep. 67 (CA).

[60] Because the question before the court was not one of choice of law to apply to a substantive dispute, but the interpretation of the obligations of an insurance contract which was governed by English domestic law.

[61] For further examples, see *Sweedman v Transport Accident Commission* [2006] HCA 8, (2006) 226 C.L.R. 362 (claim for reimbursement after payment to victim of traffic accident); *Gerling Australia Insurance Co Pty Ltd v Ludgater Holdings Ltd* [2009] NZCA 297, [2010] 2 N.Z.L.R. 145 (direct claim against insurer of tortfeasor).

English court is called upon to deal with a claim which, if it were wholly domestic, would be regarded as equitable. When such a case contains a foreign element, the question arises whether there is a category of issue labelled "equitable issues" for the purpose of choice of law. In some cases, such as where an application is made for specific performance of a contract, it will be clear that the issue is contractual, or contractual in part and procedural in part.[62] In others, such as where it is alleged that a defendant has committed a wrong which corresponds to the equitable wrongs of knowingly receiving trust property, or dishonestly assisting another in a breach of trust, it is arguable that the issue of substantive liability is to be characterised as tortious.[63] In still others, such as where it is alleged that a company director owes duties of loyalty to the company, it is arguable that the issue of substantive liability is to be characterised as falling within the category of issues reserved to the law of incorporation.[64] These instances lend no support to the proposition that the term "equitable" has a discrete role to play in the characterisation of issues for the purpose of choice of law. But other cases, principally Australian, tend to suggest that there may be a category of issues which, being labelled as "equitable", are as such governed by the *lex fori*.[65]

The most persuasive authority tends to suggest that where an obligation which would be equitable in domestic law arises in connection with another legal relationship for which a specific choice of law rule exists, the equitable claim will be characterised as falling within the domain of that other relationship and governed by the same law.[66] It follows that equitable obligations arising between parties to a contract, or to a relationship which is characterised as contractual, for example, will be governed by the *lex contractus*. However, as pointed out above, where obligations owed by one party to the other are governed, for choice of law purposes, by the statutory choice of law rule in the Rome I[67] or Rome II[68] Regulations, the first question will be whether, on its true construction, the Regulation stipulates the choice of law

[62] But where the contractual obligation is governed by the choice of law rule imposed by the Rome I Regulation, the question whether the choice of law rule stipulated by the Regulation applies to all or only some of the issues which arise for decision is answered by reference to the Regulation itself, and not by the common law principles of characterisation.

[63] See the analysis in *OJSC Oil Company Yugraneft v Abramovich* [2008] EWHC 2613 (Comm.), though if the dishonest assistance claim had arisen after the Rome II Regulation had come into effect, it is most likely that it, rather than the common law doctrine of characterisation, would have provided the applicable rule for choice of law.

[64] *Base Metal Trading Ltd v Shamurin* [2004] EWCA Civ 1316, [2005] 1 W.L.R. 1157.

[65] See further, below, paras 36–057 *et seq.*, where the cases are discussed; the Australian approach finds little support in England. See generally, Yeo, *Choice of Law for Equitable Doctrines* (2004).

[66] *Murakami v Wiryadi* [2010] NSWCA 7, (2010) 268 A.L.R. 377 (equitable obligations said to arise out of matrimonial property regime governed by the (contractual) law which governed that regime); *Fiona Trust & Holding Corp v Privalov* [2010] EWHC 3199 (Comm.), [148], [153].

[67] Regulation (EC) 593/2007 of the European Parliament and Council, examined in detail in Ch.32 below.

[68] Regulation (EC) 864/2007 of the European Parliament and Council, examined in detail in Chs 34–36 below.

rule which the court must apply. For if the answer is that it does, there is neither room nor need for a separate exercise in characterisation.

Conclusions. In essence, characterisation is a process of refining English conflict rules by expressing them with greater precision. If the relevant rule is, for example, "succession to movables is governed by the *lex domicilii* of the deceased," characterisation involves deciding precisely which issues should be governed by the *lex domicilii*. The term "succession" is simply a useful way of referring to the bundle of issues that are regarded as appropriate for determination by the *lex domicilii*. To believe that a term such as "succession" has an objectively defined meaning which exists independently of the purpose for which it is used is mere conceptualism. It is, therefore, pointless to search for the "true" meaning of the term. Moreover, since the purpose of the exercise is to reformulate rules of English law, it is contrary to principle to look to foreign law for the answer. This seems to have been recognised by the English courts. For example, in *Macmillan Inc v Bishopsgate Investment Trust Plc (No.3)*, a recent English case in which the issue of characterisation received extended judicial discussion, Auld L.J. accepted that "the proper approach is to look beyond the formulation of the claim and to identify according to the *lex fori* the true issue or issues thrown up by the claim and the defence."[69] **2–038**

The way the court should proceed is to consider the rationale of the English conflict rule and the purpose of the rule of substantive law to be characterised. On this basis, it can decide whether the conflict rule should be regarded as covering the rule of substantive law.[70] In some cases, the court might conclude that the rule of substantive law should not be regarded as falling within either of the two potentially applicable conflict rules. In this situation, a new conflict rule should be created. As Mance L.J. said in *Raiffeisen Zentralbank Österreich AG v Five Star General Trading LLC*,[71] when dealing with the characterisation of issues: **2–039**

> "The overall aim is to identify the most appropriate law to govern a particular issue. The classes or categories of issue which the law recognises at the first stage [i.e. for characterisation] are man-made, not natural. They have no inherent value, beyond their purpose in assisting to select the most appropriate law. A mechanistic application, without regard to the consequences, would conflict with the purpose for which they were conceived.

[69] [1996] 1 W.L.R. 387, 407 (CA). The decision was discussed and applied by the Court of Appeal in *Raiffeisen Zentralbank Österreich AG v Five Star General Trading LLC* [2001] Q.B. 825 (CA), and in *Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579, [2012] 2 W.L.R. 199 (characterisation of "capacity" of a corporation to be undertaken in a broad internationalist sense).

[70] This approach borrows from interest analysis, but it is used to develop and refine the traditional English rules of the conflict of laws, not to replace them.

[71] [2001] Q.B. 825 (CA), at [27]. See also *Haugesund Kommune v Depfa ACS Bank* [2010] EWCA Civ 579, [2012] 2 W.L.R. 199 (characterisation of "capacity" of a corporation to be undertaken in a broad internationalist sense).

accordingly a corporation is domiciled in the country under whose law it was created. Thus a company formed under the Companies Act 2006 has an English domicile if it is registered in England and a Scottish domicile if it is registered in Scotland, and a company incorporated under the law of France has a French domicile regardless of where it is domiciled in the eyes of French law. An individual may only have one domicile at any one time.[7] Similarly, a corporation incorporated in a single country may, presumably, only have one domicile, which will be in that country.[8] However, the question arises as to whether, by being incorporated in two or more countries, a corporation may, as a result, be domiciled in each of these countries.[9] This question has received no substantial consideration in English case law.[10] However, it is suggested that were such circumstances to arise then a corporation incorporated in two countries (or more)[11] may be recognised as so incorporated, if, under the law of each such country, this situation is recognised as having come about. Accordingly, an English court should recognise such a corporation as having a domicile in each of those countries by virtue of being incorporated there.[12] It follows from this that a corporation may change its domicile by being dissolved in one of the countries in which it is incorporated, so that it is incorporated and domiciled in only one country, and also by re-incorporating in a country different to one or more of the countries in which it is already incorporated, providing, always, that the change is recognised by the existing and new country of domicile.[13] This does not, however, permit a corporation to change its domicile as a result of its own volition,[14] since the efficacy of the change is subject to the control of each of those systems of law.

A company incorporated under the Companies Act 2006 cannot be re-incorporated elsewhere so as to have more than one domicile. Should shareholders in such a company wish to re-incorporate in Russia and do so, then, as a matter of English law, two distinct corporations (one Russian and one **30–003**

[7] See above, Rule 6.

[8] *Saccharin Corp Ltd v Chemische Fabrik von Heyden* [1911] 2 K.B. 516, 527 (CA). See also *Australian Securities and Investment Commission v Medical Defence Association of Western Australia* [2005] FCAFC 173.

[9] See Smart, pp.354–357.

[10] See *Carl Zeiss Stiftung v Rayner & Keeler Ltd (No.3)* [1970] Ch. 506, 544; *Hughes v Hannover Ruckversicherungs-Aktiengesellschaft* [1997] 1 B.C.L.C. 497 (CA) (change of domicile).

[11] Some countries have legislation explicitly permitting re-incorporation. See Smart [1990] J.B.L. 126, 134–135.

[12] Smart, *ibid.* In the United States a corporation may be re-incorporated in another State and thus may have more than one domicile: see *Jacobson v New York, New Haven and Hartford Ry*, 347 U.S. 909 (1953).

[13] Smart [1990] J.B.L. 126; Nygh (1976) 12 U. of W.A.L. Rev. 466. See *Carl Zeiss Stiftung v Rayner & Keeler Ltd (No.3)* [1970] Ch. 506, 544; *Hughes v Hannover Ruckversicherungs-Aktiengesellschaft* [1997] 1 B.C.L.C. 497 (CA) (assumed that a company originally incorporated in Massachusetts but which relocated to Bermuda became domiciled in Bermuda after complying with the requirements of Bermudan law). See also *Australian Securities and Investment Commission v Medical Defence Association of Western Australia*, above.

[14] *Gasque v Inland Revenue Commissioners* [1940] 2 K.B. 80, 84. See also *Australian Securities and Investment Commission v Medical Defence Association of Western Australia*, above.

English) are created.[15] And if a foreign corporation's shareholders purport to re-incorporate in England under the Companies Act 2006, then what is created is a new English company which is legally distinct from its foreign counterpart.[16]

30–004 The domicile of a corporation is independent of the domicile (or domiciles) of the persons who are its members. Thus, the D Co, being registered in England, has its domicile in England, but its shareholders may have their domiciles in different countries according to the rules of residence and intention applicable to natural persons.[17]

30–005 **Clause (2) of the Rule.** The residence of a corporation may be important in determining its liability to United Kingdom taxation. A company incorporated in the United Kingdom is to be regarded, for taxation purposes, as resident there.[18] The place of residence of a foreign corporation is, however, the country wherein the central management and control of the corporate affairs is actually to be found.[19] Neither the place of incorporation[20] nor the country in which central management and control ought to be exercised[21] is therefore necessarily the place of residence of such a corporation. The views of foreign courts upon a corporation's residence are (like their views upon the corporate domicile) irrelevant in England. Where a legislative provision refers to the "ordinary residence" of a corporation, the central management and control test is likely to be adopted to determine where this place is.[22] The expression "ordinary" connotes a degree of continuity being required and is a reference to the way in which things are usually or habitually ordered.[23]

30–006 The House of Lords held in *Swedish Central Railway v Thompson*,[24] that a corporation may have more than one residence. At first sight this conclusion is inconsistent with a test based upon central management and control. The Court of Appeal sought[25] to avoid the difficulty by suggesting (obiter) that

[15] *Re Irrigation Company of France Ltd, Ex p. Fox* (1871) L.R. 6 Ch. App. 176; Smart, pp.356–357.

[16] *ibid.*

[17] See above, Ch.6.

[18] See Income and Corporation Taxes Act 1988, s.749, in force from January 1, 2011. The fact that the place of central management and control is elsewhere is irrelevant: *ibid.*

[19] This place may also be described as the "place of effective management": see Income and Corporation Taxes Act 1988, s.749(3)(a), in force from January 1, 2011. But other connecting factors may also be relevant: see s.749 (1)–(6); see also s.748, 748A.

[20] *cf. Egyptian Delta Land and Investment Co v Todd* [1929] A.C. 1.

[21] *Unit Construction Co Ltd v Bullock* [1960] A.C. 351; *Re Little Olympian Each Ways Ltd* [1995] 1 W.L.R. 560.

[22] *Re Little Olympian Each Ways Ltd*, above.

[23] *ibid. cf. Union Corporation v IRC* [1952] 1 All E.R. 646, 650, 654 (CA), *Levene v IRC* [1928] A.C. 217, 225.

[24] [1925] A.C. 495. Contrast *Egyptian Delta Land and Investment Co v Todd* [1929] A.C. 1; and upon the contrast see *Unit Construction Co Ltd v Bullock* [1960] A.C. 351, 361, 367–369. See also *Dinkha Latchin v General Mediterranean Holdings SA* [2002] C.L.C. 330.

[25] *Union Corporation v IRC* [1952] 1 All E.R. 646, 654–663 (CA) (affirmed on another ground [1953] A.C. 482). Parliament may, of course, provide a legislative solution to the problem of dual residence in particular cases: see, e.g. Income and Corporation Taxes Act 1988, s.749(2), (3), in force from January 1, 2011. See also *International Credit and Investment Co (Overseas) Ltd v Adham* [1994] B.C.L.C. 66, affirmed [1999] I.L.Pr. 302 (CA).

"central management and control" should not be equated with "the power of final arbitrament." Although the latter must invariably be in one place, the former (it was said) may be divided. This solution appears to be unsound,[26] since the House of Lords has said[27] that the place of central management and control is the place of paramount authority. The circumstances of a particular corporation may exceptionally be such that it is impossible in fact to identify one country as the place of central management and control since paramount authority "may be divided or even, at any rate in theory, peripatetic."[28] It is submitted that it is in such exceptional cases that dual residence occurs and that the corporation is resident in each country where "some portion of controlling power and authority can be identified."[29] Where it is necessary to determine the country in which a corporation is "ordinarily" resident, then other than in exceptional circumstances, application of the central management and control test is likely to lead to only one place of "ordinary" residence.[30]

30–007 "Residence" for the purpose of ascertaining a corporation's amenability to jurisdiction is different from the concept embodied in Rule 173. It is discussed elsewhere in this book.[31]

Illustrations

30–008 1. X is a company incorporated in South Africa. The bulk of the company's business consists in exploiting South African diamond mines, and the head office is at Kimberley. There are both South African and English directors, and separate board meetings are held weekly in Kimberley and London. The day-to-day management of the company's affairs is conducted by the South African directors at Kimberley, but major policy decisions are made by a majority of all the directors. A majority of the directors has always resided in England. The company is resident in England.[32]

2. X is a company incorporated in the Cayman Islands. The company is formed solely for the purpose of constructing and working a railway in Sweden, but after the railway has been built it is leased to a Swedish company. Meetings of both the board and the shareholders are held in Sweden or London, by rotation. There are equal numbers of English and Swedish shareholders and directors. The company is resident in both England and Sweden.[33]

[26] Farnsworth (1952) 68 L.Q.R. 307. The writer's criticism is adopted in the text.

[27] *San Paulo (Brazilian) Ry v Carter* [1896] A.C. 31, 41; *American Thread Co v Joyce* (1913) 108 L.T. 353, 354; *New Zealand Shipping Co v Thew* (1922) 8 T.C. 208, 229; *Bradbury v English Sewing Cotton Co Ltd* [1923] A.C. 744, 753.

[28] *Unit Construction Co Ltd v Bullock* [1960] A.C. 351, 366.

[29] *ibid.* p.367, *per* Lord Radcliffe, who expressly reserved for future consideration whether this is the correct method of fixing residence where paramount authority is split or peripatetic. See Farnsworth, *The Residence and Domicile of Corporations* (1939), pp.106–121.

[30] *Re Little Olympian Each Ways Ltd* [1995] 1 W.L.R. 560.

[31] For jurisdiction of English courts, see above, paras 11R–001 *et seq.*; and for jurisdiction of foreign courts, see above, paras 14R–001 *et seq.* A corporation may be, for certain purposes be accorded a "habitual residence", in relation, for example, to particular choice of law rules and this concept may be defined in the relevant legislation: see Rome I Regulation, Art. 19; Rome II Regulation, Art.23.

[32] *De Beers Consolidated Mines v Howe* [1906] A.C. 455. See also *Re Little Olympian Each Ways Ltd*, above.

[33] *cf. Swedish Central Ry v Thompson* [1925] A.C. 495.

TAB 103

Black's Law Dictionary®

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comites (**kom**-ə-teez). See COMES.

comites paleys (**kom**-ə-teez-pa-**lays**). [Law French] (17c) *Hist.* Counts or earls palatine; those who exercise royal privileges in a county palatine. See COUNTY PALATINE.

comitia (kə-**mish**-ee-ə), *n.* [Latin "assembly"] (17c) *Roman law.* An assembly of the Roman people, gathered together for legislative or judicial purposes. • Women were excluded from participation.

▸ ***comitia centuriata*** (kə-**mish**-ee-ə sen-tyoor-ee-**ay**-tə). (*often cap.*) (16c) An assembly of the entire populace, voting by centuries (that is, military units) empowered to elect magistrates and to act as a court of appeal in a capital matter.

> "The *Comitia Centuriata*, said to have been originated by the sixth King, Servius Tullius, included the whole Roman people arranged in classes according to their wealth, so as to give the preponderating power to the richest. During the regal period it was a military organisation on the basis of property: under the Republic it became a legislative body, ousting the *Comitia Curiata*." William A. Hunter, *Introduction to Roman Law* 16 (F.H. Lawson ed., 9th ed. 1934).

▸ ***comitia curiata*** (kə-**mish**-ee-ə kyoor-ee-**ay**-tə). (*often cap.*) (17c) An assembly of (originally) patricians whose chief function was to authorize private acts of citizens, such as declaring wills and adoptions. • The *comitia curiata* engaged in little legislative activity.

> "The oldest [of the four assemblies of the Roman people] was the *Comitia Curiata*. In the regal period this assembly consisted of the *Populus Romanus* in its thirty curies (or family groups): it could meet only by summons of the King; it merely accepted or rejected the proposals submitted by him, without the right of discussion or amendment; nor was any decision by it valid without the authorisation of the Senate. Under the Republic it rapidly fell into the background, though it formally existed, represented by thirty lictors, down into Imperial times: for the private law its main importance lay in its meetings under pontifical presidency to deal with matters of religious significance, such as adrogations and wills." William A. Hunter, *Introduction to Roman Law* 15-16 (F.H. Lawson ed., 9th ed. 1934).

▸ ***comitia tributa*** (kə-**mish**-ee-ə tri-**byoo**-tə). (*often cap.*) (17c) An assembly of tribes convened to elect lower-ranking officials. • The *comitia tributa* undertook a great deal of legislative activity in the later Roman republic. Cf. CONCILIUM PLEBIS.

> "The *Comitia Tributa* was the assembly of the whole Roman people in their tribes — a regional classification. In this assembly the influence of numbers predominated." William A. Hunter, *Introduction to Roman Law* 16 (F.H. Lawson ed., 9th ed. 1934).

comity (**kom**-ə-tee). (16c) **1.** A practice among political entities (as countries, states, or courts of different jurisdictions), involving esp. mutual recognition of legislative, executive, and judicial acts. — Also termed *comitas gentium*; *courtoisie internationale.* See FEDERAL-COMITY DOCTRINE; JUDICIAL COMITY. Cf. ABSTENTION.

> "'Comity,' in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws." *Hilton v. Guyot*, 159 U.S. 113, 163-64, 16 S.Ct. 139, 143 (1895).

2. INTERNATIONAL LAW. • This sense is considered a misusage: "[I]n Anglo-American jurisprudence, . . . the term is also misleadingly found to be used as a synonym for international law." Peter Macalister-Smith, "Comity," in 1 *Encyclopedia of Public International Law* 672 (1992). **3.** See *private international law* under INTERNATIONAL LAW.

Comity Clause. (1921) *Constitutional law.* The clause of the U.S. Constitution giving citizens of one state the right to all privileges and immunities enjoyed by citizens of the other states. U.S. Const. art. IV, § 2, cl. 1. See PRIVILEGES AND IMMUNITIES CLAUSE.

comm. *abbr.* **1.** COMMONWEALTH. **2.** Committee. **3.** *Archaic.* Commission.

command. (14c) **1.** An order; a directive. **2.** In legal positivism, the sovereign's express desire that a person act or refrain from acting a certain way, combined with the threat of punishment for failure to comply.

> "Commands are orders backed by threats. It is in virtue of threatened evils, sanctions, that expressions of desire not only constitute commands but also impose an obligation or duty to act in the prescribed ways." Martin P. Golding, *Philosophy of Law* 26 (1975).

command, *vb.* (13c) To direct authoritatively; to order.

commander-in-chief. (17c) **1.** Someone who holds supreme or highest command of armed forces. **2.** (*cap.*) The title of the U.S. President when acting as the constitutionally designated leader of the country's military. U.S. Const. art. II, § 2.

Commander in Chief Clause. (1947) *Constitutional law.* The clause of the U.S. Constitution appointing the President as supreme commander of the military. U.S. Const. art. II, § 2, cl. 1.

commandment. (13c) *Hist.* **1.** An authoritative order of a judge or magisterial officer. **2.** The offense of inducing another to commit a crime.

command post. (1918) The place from which military leaders and their officers control activities.

command rape. See RAPE (2).

commencement. See INTRODUCTORY CLAUSE.

commencement date. See *effective date* under DATE.

commencement of an action. (18c) The time at which judicial or administrative proceedings begin, typically with the filing of a formal complaint. *See Unexcelled Chem. Corp. v. U.S.*, 345 U.S. 59, 66, 73 S.Ct. 580, 584 (1953).

commencement of infringement. (1878) *Copyright.* The first of a series of discrete copyright violations, such as the first of many separate sales of infringing items. See INFRINGEMENT.

commenda (kə-**men**-də). A business association in which one person has responsibility for managing all business property.

commendam (kə-**men**-dam *or* -dəm). (16c) **1.** *Hist. Eccles. law.* A vacant benefice held by a clerk until a regular pastor could be appointed. • Bishops and other dignitaries found commendams to be lucrative sources of income. Commendams were abolished in England in 1836. See BENEFICE. **2.** Partnership in commendam. See *limited partnership* under PARTNERSHIP.

commendation. (1818) *Hist.* The act of becoming a lord's feudal tenant to receive the lord's protection.

TAB 104

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Statutory Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

BANKRUPTCY, INSOLVENCY AND RESTRUCTURING LAW SECTION AND CANADIAN CORPORATE COUNSEL ASSOCIATION OF THE CANADIAN BAR ASSOCIATION

July 2014

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PREFACE

The Canadian Bar Association is a national association representing 37,500 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, Insolvency and Restructuring Law Section and the Canadian Corporate Counsel Association 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 Bankruptcy, Insolvency and Restructuring Law Section and the Canadian Corporate Counsel Association of the Canadian Bar Association.

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BIA and CCAA Review

I. EXECUTIVE SUMMARY

The Canadian Bar Association (CBA) is pleased to comment on Industry Canada's statutory review of the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA) published on May 16, 2014. The CBA is a national association representing over 37,500 jurists, including lawyers, Quebec notaries, law teachers and students across Canada. Its primary objectives include improvement to the law and the administration of justice.

These comments are the collective work of the CBA's National Bankruptcy, Insolvency and Restructuring Law Section as well as the Canadian Corporate Counsel Association of the CBA (CBA Sections). The CBA Sections have a long history of contributions to government reform initiatives on insolvency law. Most recently, we commented on the amendments arising from the last mandated five year review of the BIA and CCAA, in addition to the 2008 study by the Senate Banking Committee on Bankruptcy and Insolvency Legislation.

Our comments are organized according to the headings in the discussion paper.

Part 1 – Protection of Consumer Interests

The CBA Sections do not recommend amending the BIA to provide a priority charge or interest in favour of consumers who provide deposits or pre-payments. Creating a statutory charge or other priority interest may restrict retailers' access to credit and impose an administrative burden on trustees and receivers.

We question the effectiveness of a new category of preferred claim. The property of a debtor is typically fully encumbered and there are often little or no recoveries for preferred creditors in a bankruptcy. However, we do not oppose the creation of a preferred claim for deposits or pre-payments on the basis that preferred claims would have to be paid in priority to other creditors in a reorganization of the debtor.

The CBA Sections do not support sanctioning creditors by giving the trustee or the court jurisdiction to disallow the claims of creditors who do not meet duties imposed in connection with pre-insolvency loans to a debtor.

Part II – The "Fresh Start" Principle

The affirmation of pre-bankruptcy obligations may undermine the fresh start principle and the objective of treating creditors of equal rank on an equitable basis. We question whether there is a sound policy basis to permit the affirmation of pre-bankruptcy obligations, other than secured obligations, by a (discharged) bankrupt.

The CBA Sections do not believe there is a need for a bankrupt to affirm or adopt pre-bankruptcy agreements as they continue in force post-bankruptcy subject to being terminated by the other party. If the affirmation of discharged obligations is permitted, we suggest it be done by way of an express agreement.

Part III – Consumer Exemptions

We generally support amending the BIA to exclude amounts in Registered Education Savings Plans (RESPs) from the property of a debtor subject to distribution to creditors in a bankruptcy. However, provisions should be included to ensure that funds contributed to an exempt RESP are applied for the benefit of the beneficiary of the RESP and not paid out to the (bankrupt) subscriber(s).

In addition, we recommend that the capital in a Registered Disability Savings Plan (RDSP) be excluded from the property of a debtor available for distribution to creditors in a bankruptcy on the same terms as RESPs and Registered Retirement Income Funds (RRIFs).

We recommend that the current system for exemption lists be maintained.

Part IV – Treatment of Student Loans in Bankruptcy

Although we believe it is appropriate to have a waiting period in the BIA so that students cannot immediately use the bankruptcy process to discharge student loans, the current waiting periods imposes too high of a burden on many debtors. Five years is sufficient to deter students who do not have financial difficulty from using bankruptcy as a way to discharge. The time periods for relief should be calculated from the date the debtor was last a student in the program for which the government-funded student loan relief was granted.

We recommend, however, eliminating the waiting period for a release of government-funded student loans on the grounds of hardship. At minimum, it should be reduced to a shorter period of one or two years.

We also recommend that s. 178(1.1) be amended to allow the court to order that student debt is discharged, in whole or in part, on terms or subject to conditions the court may impose.

Part V – Commercial Issues

Intellectual Property Rights

We recommend that the BIA and the CCAA be amended to include a definition of intellectual property (IP) and that IP be broadly defined to include all forms of IP, registered or otherwise, that may be subject to a license.

We recommend that the court be required to specifically consider the interests of the other party(ies), including the owner of any licensed IP.

In terms of the rights of licensees in other proceedings, we recommend that: (a) the BIA and CCAA be amended to provide that license rights cannot be "vested out" in any sale of IP by a debtor; (b) the BIA should include the ability of a receiver within the meaning of s. 243(2) or a Bankruptcy Trustee to not perform/disclaim license agreements and the effect of non-performance/disclaimer on the licensee; and (c) the BIA should contemplate the sale of property by a Receiver within the meaning of s. 243(2) and the jurisdiction of the Court to vest out license rights.

We support the application of the BIA on the sale by a Trustee of property subject to IP rights to sales by a Receiver within the meaning of s. 243(2) of the BIA.

Encouraging Re-structuring

The CBA Sections endorse the consolidation of the BIA, CCAA and the *Winding-up and Restructuring Act* (WURA) into a single Insolvency Act applicable to all insolvent liquidation (bankruptcy or liquidation/ winding-up) and reorganization proceedings.

Under current CCAA proceedings, we do not oppose the monitor taking on a more active role, but do not support expanding the role to include the resolution of substantive disputes between stakeholders in the reorganization process. It should be noted that professional fees of the monitor and its advisors are a significant part of the cost of litigation.

We do not believe it is necessary to mandate the appointment of a committee of creditors funded by the debtor. The CBA Sections recommend considering whether the appointment of the monitor or proposal trustee should be subject to approval by creditors early in the reorganization proceeding.

We recommend that, in addition to the fees of the insolvency administrator and its counsel, professional fees of all stakeholders paid by the debtor be subject to approval by the court.

The CBA Sections recommend that proceedings under the CCAA be by way of a regulatory filing akin to a Notice of Intention to Make a Proposal. This would eliminate the need for a pre-filing report. Alternatively, the information in a pre-filing report should be prescribed based on the relief being sought by the debtor on the initial application.

In terms of CBCA arrangements, though they may provide a desirable alternative, in our view, the CCAA affords more robust protections to creditors. CCAA proceedings need not be more expensive than a CBCA arrangement designed to accomplish the same objective, particularly if provisions are added to the CBCA arrangement proceedings to protect the interests of creditors.

We recommend amending Part III of the BIA to include a Division III, which would apply to an insolvent person or bankrupt, other than individuals, where the claims against the person do not exceed $500,000.

The CBA Sections support amending the BIA to give the court jurisdiction, in appropriate circumstances, to provide a debtor subject to proceedings under Division I more than six months to file a proposal.

The CBA Sections are concerned about the cost of attendances to extend the time for a debtor to make a proposal under Division I of the BIA. We recommend considering amending the BIA to extend the maximum 45 day extension to 60 days, and require that, after the initial extension, the debtor apply for an extension only if required to do so by X creditors representing Y percentage of the claims in writing no less than Z days prior to the expiry of the period, failing which the time for making a proposal would be automatically extended for an additional 60 days.

In a CCAA liquidation, we recommend amending the obligation, as part of the Monitor's duties, to report to the court if the monitor believes it would be more beneficial to the creditors if the proceedings were taken under the BIA.

Enhancing Equity

We recommend that the BIA and CCAA be amended so the assignment of agreements parallel the sale of assets provisions and require the court be satisfied that employee and pension-related claims can and will be paid.

It is not necessary to include specific jurisdiction to authorize the debtor to make hardship payments to creditors (or employees) or impose limits on the court's jurisdiction to make an order authorizing (or directing) a hardship payment in the CCAA or BIA.

We recommend that third-party releases be available only where:

- the parties to be released are necessary and essential to the restructuring;
- the claims to be released are rationally related to the purpose of the plan and necessary for it;
- the plan cannot succeed without the releases;
- the parties having the claims against them released were contributing in a tangible and realistic way to the plan; and
- the plan benefits the debtor and creditors generally.

The BIA and CCAA should prohibit awarding bonuses or key employee retention payments (KERP) to directors, officers or employees who are related to the debtor (or directors or officers of the debtor) except with court approval. In addition, the BIA or CCAA should not make officers and directors personally liable for employee remuneration, including any bonuses.

The CBA Sections are opposed to any amendments that would limit the ability of creditors to take advantage of a statutory right provided for their benefit. In our view, there is no justification for limiting or removing the right of creditors or a bankruptcy trustee from seeking an oppression remedy.

Deterring Fraud and Abuse

We do not believe it is appropriate for federal insolvency legislation to address whether an individual can sit as a director of a solvent corporation.

In our view, it is inappropriate to deny a person with a legitimate claim or set-off right the ability to recover that claim (or exercise the set-off right) on the basis only that the creditor is related to the debtor.

Cross-Border Insolvencies

Consideration should be given to amending the BIA and CCAA to give the court jurisdiction to determine whether claims against a debtor arising under a foreign law and not related to any obligations of the debtor ought to be recognized.

We recommend that Canada wait for the results of the UNCITRAL working group on the treatment of enterprise groups in cross-border insolvency prior to making any amendments to the BIA or CCAA in this area.

Where Canadian creditors receive notice in advance of the recognition of a foreign jurisdiction as the centre of main interest (COMI) of a Canadian debtor, we believe that all stakeholders should have the opportunity to make submissions on the recognition of a foreign proceeding and the relief being sought.

In our view, it would not be appropriate to adopt general principles and criteria for the recognition of foreign Unsecured Creditor's Committees (UCCs) in Canadian insolvency proceedings or to define the scope of UCC participation in Canadian insolvency proceedings. The court has adequate tools to ensure that the participation of UCCs in Canadian insolvency proceedings does not become disruptive or result in other stakeholders incurring unnecessary costs. We do not support legislative barriers on the ability of UCCs to participate in Canadian insolvency proceedings.

Part VI – Administrative Issues

The CBA Sections do not object to the BIA being renamed the Insolvency Act. Amending the name would be particularly appropriate for a single unified insolvency statute or to codify the law on receivers appointed over insolvent debtors.

Although we are in favour of a unified Insolvency Act, some provisions of the CCAA are intended to facilitate the reorganization of larger, more complex businesses. Care must be given to ensure that any necessary distinctions on the relief available to debtors based on size can be accomplished in a consolidated Insolvency Act.

Merging the BIA and CCAA would present an opportunity to address the ever-increasing cost of the CCAA insolvency regime by eliminating the requirement for the debtor to apply to the court seeking to commence CCAA reorganization proceedings.

In a Division II proposal, we do not believe there is any compelling reason why business debt cannot be accommodated.

We do not oppose the broad application of the BIA and CCAA to trusts.

The CBA Sections support the amendments to codify the powers of a receiver defined by s. 243(2) of the BIA. We also support the amendment of s. 215 of the BIA to include receivers within the meaning of s. 243(2) of the BIA.

The CBA Sections do not, in theory, oppose amending the BIA to provide for the application of marshalling in favour of the trustee to permit the court, on the application of the trustee, to require a secured creditor with recourse of multiple pools of assets to resort to those pools in a manner that maximizes the property available to creditors. The issue that arises in a bankruptcy is whether marshalling can apply in favour of unsecured creditors or the trustee.

We support amending s. 244 of the BIA to require advance notice by any person who wishes to enforce any right over all or substantially all of the specific property of an insolvent debtor to satisfy a debt claim.

We do not support re-vesting accounts in a debtor on filing a Notice of Intention to Make a Proposal or a Proposal in circumstances where CRA has done everything required to effect the transfer of title to the account(s). The CBA Sections would, however, support amending the BIA to provide that an involuntary transfer of title may be a preference or transfer at undervalue.

Part VII – Technical Issues

There is no need to provide specific jurisdiction to award costs against a debtor in connection with a discharge hearing as courts already have jurisdiction under s. 197(1) of the BIA to do so.

The CBA Sections support amending s. 204.3(1) of the BIA to clarify the jurisdiction of the court to make an order compensating a person who is the victim of a bankruptcy offence or the estate for any damage or loss.

We do not oppose amending s. 135(4) to remove the requirement that a person whose claim has been determined or disallowed by the trustee pursuant to s. 135(1.1) or (2) seek to extend the 30 day appeal period.

The CBA Sections do not oppose amending the BIA to permit securities regulators or customer compensation bodies to bring an application under s. 43 in respect of securities firms subject to Part XII.

Part VIII – Other Issues

We do not believe there is a sound policy basis for applying a provincial limitation period to avoidance proceedings by a bankruptcy trustee under the BIA. The application of provincial limitation periods could result in avoidance proceedings available for the benefit of creditors in lengthy CCAA proceedings being statute barred by the time a plan that permits the avoidance proceedings to be pursued is filed.

We recommend that s. 135 of the BIA be amended to provide for the determination of claims filed against a debtor where a Receiver within the meaning of s. 243(2) is appointed over the debtor's property. We recommend that ss. 81.5 and 81.6 be amended to provide that claims under the pension charge will be established by filing a Proof of Claim in the prescribed form and that Form 31 be amended accordingly.

We recommend that the BIA be amended to provide that the appointment of a receiver in the meaning of s. 243(2) is an initial bankruptcy event.

The CBA Sections recommend that the BIA provisions applicable to agreements with bankrupt individuals be extended to apply to all bankrupts.

We recommend that s. 47.2(2) of the BIA be repealed.

The classification of creditors provisions in the BIA should apply to creditors generally and the criteria in the BIA and CCAA should be expanded to include factors identified by the court as relevant to the classification of creditors based on commonality of interest.

II. INTRODUCTION

The Canadian Bar Association (CBA) is pleased to comment on Industry Canada's statutory review of the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA) published on May 16, 2014. The CBA is a national association representing over 37,500 jurists, including lawyers, Quebec notaries, law teachers and students across Canada. Its primary objectives include improvement to the law and the administration of justice.

These comments are the collective work of the CBA's National Bankruptcy, Insolvency and Restructuring Law Section as well as the Canadian Corporate Counsel Association of the CBA (CBA Sections). The CBA Sections have a long history of contributions to government reform initiatives on insolvency law. Most recently, we commented on the amendments arising from the last mandated five year review of the BIA and CCAA, in addition to the 2008 study by the Senate Banking Committee on Bankruptcy and Insolvency Legislation.

Our comments are organized according to the headings in the discussion paper.

III. PROTECTION OF CONSUMER INTERESTS

2.1 Consumer Deposits

The discussion paper notes that a retailer may receive payment, in whole or in part, before providing the contracted goods or services to a customer. However, if that same retailer becomes bankrupt or a receiver is appointed over the retailer's assets before those goods or services are delivered, the customer is an unsecured creditor for the prepaid amount. The issue of customer pre-payments or deposits can also arise in reorganization proceedings[1] and may extend beyond the retail sector of the economy.

Two options are available to protect the interests of customers who provide deposits or pre-payments in an insolvency proceeding: (1) a consumer charge or other statutory priority interest in the debtor's property akin to that provided for environmental, employee remuneration, pension and some supplier-related claims; or (2) amending s. 136 of the BIA to provide for a preferred claim in a bankruptcy.

The CBA Sections do not recommend amending the BIA to provide a priority charge or interest in favour of consumers who provide deposits or pre-payments. Creating a statutory charge or other priority interest may restrict retailers' access to credit and impose an administrative burden on trustees and receivers. There is not sufficient data to suggest that a priority charge or interest is necessary. Customers often already have recourse where a deposit or

[1] See, for example, *Livent Inc. (Re),* 1998 CanLII 14718 (ON SC) aff'd, 1999 CanLII 3800 (ON CA).

prepayment is made by credit card (these credit card charges can often be reversed), and the court has jurisdiction to impose a constructive trust as a remedy for unjust enrichment.[2]

We echo the discussion paper in questioning the effectiveness of a new category of preferred claim. The property of a debtor is typically fully encumbered and there are often little or no recoveries for preferred creditors in a bankruptcy. However, we do not oppose the creation of a preferred claim for deposits or pre-payments on the basis that preferred claims would have to be paid in priority to other creditors in a reorganization of the debtor.[3]

In proceedings under the CCAA and receiverships, it is possible for the court to authorize a debtor company to honour obligations such as deposits and pre-payments.[4]

2.2 Responsible Lending

The CBA Sections do not support sanctioning creditors by giving the trustee or the court jurisdiction to disallow the claims of creditors who do not meet duties imposed in connection with pre-insolvency loans to a debtor. Disallowing a claim against an insolvent consumer debtor is unlikely to provide a strong incentive to alter lending practices.

There does not appear to be any empirical evidence of a direct link between the behaviour of lenders and consumer insolvency. As noted in the discussion paper, the Consumer Insolvency Rate peaked during the economic downturn in 2009 and has been trending down in subsequent years, indicating that the rates of consumer insolvency may be more directly linked to economic conditions than the behaviour of lenders in extending credit.[5]

While the CBA Sections appreciate the policy underlying the imposition of a responsible lending regime, we believe that imposition on creditors is beyond the scope of the BIA. The main focus of the BIA vis-à-vis consumer debtors ought to be their rehabilitation. Banks, credit unions and other lenders are held to strict provincial, territorial and federal regulations that include detailed disclosure of the cost of borrowing and advice on other possible perils of excessive borrowing.

[2] See *Barnabe v. Touhey*, 1994 CanLII 7264 (ON SC). The imposition of a constructive trust was overturned on appeal, but the Court of Appeal found that a constructive trust could be imposed in a bankruptcy: 1995 CanLII 1672 (ON CA)

[3] See BIA, s. 60(1).

[4] See *The Futura Loyalty Group Inc. (Re),* 2012 ONSC 6403 (CanLII)

[5] Other factors such as marriage breakdown, gambling, etc. also contribute to consumer insolvency.

IV. THE “FRESH START” PRINCIPLE

3.1 Licence Denial Regimes

There are disparate viewpoints among the CBA Sections on License Denial Regimes. The Canadian Corporate Counsel Association of the CBA does not support the following.

The Bankruptcy, Insolvency and Restructuring Law Section of the CBA recommends that the BIA be amended to expressly prohibit the denial, revocation, suspension or refusal to renew a licence based solely on non-payment of a debt that is subject to discharge or compromise. Fresh starts should not be limited to driver’s licences or vehicle registrations, but should extend to all licences, including to practice a profession.

Licence denial regimes may be used to enforce collection of monetary obligations, even though the debts are stayed and then discharged or compromised through an insolvency process. These regimes may, for example, permit a creditor to deny a driver’s licence or vehicle registration to a debtor unless they pay an obligation that is discharged. A fresh start for the honest but unfortunate debtor and fair treatment of creditors of the same class or rank are fundamental policy objectives of the BIA.[6] Licence denial regimes thwart these policy objectives.

If the government wishes to ensure that the debtor pays certain debts post-bankruptcy, s.178 of the BIA should be amended to include any such debts.

3.2 Affirmation Agreements

The affirmation of pre-bankruptcy obligations may undermine the fresh start principle and the objective of treating creditors of equal rank on an equitable basis. However, there are situations where it is desirable for a bankrupt to voluntarily agree to continue to pay an obligation that would otherwise be discharged, for example, a car lease or the mortgage on a principal residence. In 2009, the BIA was amended to restrict the ability of a person to terminate an agreement, including a security agreement or lease, with a bankrupt individual.[7] A secured lender is prohibited from terminating a security agreement on the basis that an

[6] See, for example, *Canada (Superintendent of Bankruptcy) v. 407 ETR Concession Company Limited,* 2013 ONCA 769 (CanLII).

[7] See BIA, s. 84.2.

individual is insolvent or has become bankrupt and a lessor is prohibited from terminating a lease on the basis of failure to pay pre-bankruptcy obligations.

Section 84.2 of the BIA does not prevent the termination of security agreements on the basis of non-payment of the secured debt. The issue with the affirmation of security agreements is whether the bankrupt ought to be liable for the deficiency between the value of the collateral as at date of bankruptcy and the debt secured.[8] For secured creditors in a bankruptcy, the policy appears to permit them to require the payment by the bankrupt of the entire secured debt as a condition of retaining the collateral.

The CBA Sections question whether there is a sound policy basis to permit the affirmation of pre-bankruptcy obligations, other than secured obligations, by a (discharged) bankrupt. In 2009, the decision was made to restrict the ability of parties to contracts with an individual bankrupt to exercise their contractual remedies. The policy objective underlying s. 84.2 of the BIA appears to permit individual bankrupts to maintain leased property without having to pay pre-bankruptcy obligations. It appears that if the debtor wishes to retain the use of property pledged as collateral to a secured creditor, arrangements must be made with the secured creditor and may include the payment of pre-bankruptcy obligations. The CBA Sections believe there is no need for a bankrupt to affirm or adopt pre-bankruptcy agreements as they continue in force post-bankruptcy subject to being terminated by the other party.

If the affirmation of discharged obligations is permitted, we suggest it be done by way of an express agreement. No debtor should be required, as a condition of affirming an obligation, to pay a debt that is discharged. If the BIA is amended to permit the affirmation of obligations, we recommend that the BIA: (a) require any affirmation to be in writing and made within a fixed period after the bankrupt is discharged; and (b) prohibit the other party to an affirmed obligation from recovering debts which are discharged.

Given the policy underlying the BIA that secured creditors are able to enforce their security notwithstanding a bankruptcy on the basis of non-payment of the secured debt, we recommend that these conditions on affirmation of agreements not apply to security agreements.

[8] See *CIBC Mortgage Corp. v. Coleski*, 1999 CanLII 3116 (NS SC)

There is a gap in the leases and utilities provisions of the BIA for post-bankruptcy payments. Section 84.2 prohibits the termination of agreements based on the non-payment of pre-bankruptcy payments and permits the lessor or utility to require payment post-bankruptcy. However, the claims against a bankrupt that are discharged include claims arising during the period between the date of bankruptcy and discharge.[9] Where a bankrupt retains the use of leased property or utilities post-bankruptcy, claims for post-bankruptcy use should not be discharged. We recommend amending s. 178 accordingly.

V. CONSUMER EXEMPTIONS

4.1 Registered Savings Products

In 2009, Registered Retirement Savings Plans (RRSPs) and RRIFs were exempted from the property of the debtor available for distribution to creditors in a bankruptcy, subject to a claw-back of any contributions made in the 12 months prior to bankruptcy. The goal was to protect retirement savings in the same manner as registered pension plans are exempt. A number of provinces have since made RESPs exempt.

In the last review of the BIA and CCAA, the Senate Committee on Banking, Trade and Commerce recommended the BIA be amended to exclude amounts in RESPs from the property of a debtor subject to distribution to creditors in a bankruptcy.[10] The CBA Sections generally supports this recommendation. However, provisions should be included to ensure that funds contributed to an exempt RESP are applied for the benefit of the beneficiary of the RESP and not paid out to the (bankrupt) subscriber(s).

In addition, we recommend that the capital in an RDSP be excluded from the property of a debtor available for distribution to creditors in a bankruptcy on the same terms as RESPs and RRIFs. Any payments made to insolvent persons out of an RDSP for their benefit, should be treated as income for purposes of calculating surplus income obligations.

4.2 Federal Exemption Lists

Although the adoption of a federal exemption list would promote uniformity across Canada, it may not take into account the diversity that exists across the provinces. We recommend that

[9] BIA, s. 121(1).

[10] 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* (2003).

the current system be maintained. While not ideal, it has operated effectively and ensures that every debtor within a province is treated fairly, consistently and predictably.

The BIA exempts certain property of the bankrupt from distribution to creditors. The policy recognizes that a bankrupt requires essentials such as clothing, household goods and property necessary to earn a living. The BIA does not establish a comprehensive list of property that is exempt for distribution among creditors. The BIA does provide, however, that property that is exempt from execution or seizure under provincial law is excluded from the property of the bankrupt. Provincial laws governing exempt property from execution vary across Canada.[11]

VI. TREATMENT OF STUDENT LOANS IN BANKRUPTCY

6.1 Discharge of Student Loan Provisions

The CBA Sections believe it is appropriate to have a waiting period in the BIA so that students cannot immediately use the bankruptcy process to discharge student loans, and then proceed to good paying jobs. The difficulty is in determining the length of the waiting period. In 1997, the BIA was amended to create a two-year waiting period from the time a student ceased to be a full or part-time student. In 1998, the waiting period was increased to ten years, which proved to be unduly lengthy. In 2009, the BIA was further amended to reduce the waiting period from ten to seven years or, in the case of significant financial hardship, from ten to five years. It is our view that these waiting periods impose too high of a burden on many debtors.

Students currently have access to interest relief on their student loans for at least five years after they end their studies. In all Canadian provinces, a debtor with government-funded student loans may obtain at least five years of relief from paying interest on their government-funded student loans. All provinces except Quebec provide a longer period of interest relief (up to 15 years) and the possibility to fully extinguish the debt at the end of the relief period. Reducing the waiting period under the BIA from seven years to five years would help to integrate these two systems. Five years is sufficient to deter students who do not have financial difficulty from using bankruptcy as a way to discharge. It should also be made clear in the BIA that the time periods for relief should be calculated from the date the debtor was last a student in the program for which the government-funded student loan relief was granted.

[11] See Alysia Davies, *Federal Exemptions in Bankruptcy: Canada and Three Other Countries,* Library of Parliament (2008).

6.2 Hardship Discharge

The CBA Sections recommend that a waiting period for a release of government-funded student loans on the grounds of hardship be eliminated, or at least reduced to a shorter period such as one or two years. However, the court should have explicit jurisdiction to make any discharge of student debt on the grounds of hardship subject to any conditions the court may deem appropriate.

Under the BIA, a release from government-funded student loans can be granted on grounds of hardship if the debtor satisfies the court that they acted in good faith in connection with the student loan debt and will continue to experience financial difficulties rendering them unable to pay the debt. The decision to grant relief on the grounds of hardship is in the discretion of the court on a case-by-case basis. There is currently a waiting period of 5 years before an application for relief on the grounds of hardship can be made. The CBA Sections question whether there is a valid policy basis to impose a waiting period on a hardship discharge. In granting a hardship discharge, the court must determine that the bankrupt is experiencing such financial difficulty that repayment of the student debt will be impossible. The waiting period seems somewhat arbitrary.

6.3 Partial Release of Debts

The CBA Sections recommend that s. 178(1.1) be amended to allow the court to order that student debt is discharged, in whole or in part, on terms or subject to conditions the court may impose.

Until now, courts have held that they do not have the authority to order a release of part of the student loan debt. The relief is either all or nothing. As any relief from a student loan obligation is left to the discretion of the court, it would be equitable and reasonable to permit a court, in appropriate circumstances, to order that part but not all of a particular student loan is released or that the discharge is subject to terms imposed by the court.

We do not believe it is necessary to list the factors the court should consider in a hardship application. While it may provide some guidance, the court's discretion and its analysis of whether the bankrupt has acted in good faith in connection with the student loan debt is sufficient.

VII. COMMERCIAL ISSUES

1. Encouraging Innovation through Intellectual Property Rights

The CBA Sections believe that the following amendments should be considered to improve the provisions of the BIA and CCAA that deal with intellectual property (IP) rights:

> **Definition of "Intellectual Property"**: The CCAA and BIA allow for the ongoing use of licensed IP where the license is disclaimed, but there is no definition of IP in either statute. We recommend that the BIA and CCAA be amended to include a definition of IP and that IP be broadly defined to include all forms of IP, registered or otherwise, that may be subject to a license.
>
> **Assignment of IP License**: We recommend that the court be required to specifically consider the interests of the other party(ies), including the owner of any licensed IP. The provisions of the CCAA and BIA that permit the forced assignment of rights and obligations arising under agreements apply to IP licenses. It is generally accepted that the court is not restricted by any prohibitions on assignment contained in the agreement. In the IP context, this could give rise to issues if a license is granted on terms that permit the owner of the IP to control who has rights to its IP. A debtor/licensee could, for example, assign a license to manufacture a product containing a prohibition or restriction on assignment to a competitor of the owner of the IP without the owner's consent. In considering whether to authorize the assignment, the court is required to consider whether it would be appropriate to assign the rights and obligation arising under the agreement to the proposed assignee.
>
> **Rights of Licensee in Other Proceedings:** There have been cases where the court has found that IP can be vested in a purchaser free and clear of a licensee's contractual rights. This has the practical effect of terminating the licensee's rights to use the IP. Given the 2007 amendments, there does not seem to be a sound policy reason why a party to a license to use IP should be subject to the possibility that this right could summarily be terminated by the insolvency of the licensor depending on the insolvency proceeding to which the debtor is subject.

The CBA Sections recommend:

a) the BIA and CCAA be amended to provide that license rights cannot be "vested out" in any sale of IP by a debtor;

b) the BIA should include the ability of a receiver within the meaning of s. 243(2) or a Bankruptcy Trustee to not perform/disclaim license agreements and the effect of non-performance/disclaimer on the licensee;

c) the BIA should contemplate the sale of property by a Receiver within the meaning of s. 243(2) and the jurisdiction of the Court to vest out license rights.

Receivership: We support the application of the BIA on the sale by a Trustee of property subject to IP rights to sales by a Receiver within the meaning of s. 243(2) of the BIA. There is no compelling reason why the owners of IP should not to be afforded the same protection in a receivership as they are afforded in a bankruptcy.

Other Intellectual Property Rights: The CBA Sections endorse the adoption of protections similar to those afforded to the holders of copyright and patent rights to the holders of other intellectual property rights.

2. Encouraging Restructuring

2.1 Streamlining Companies' Creditors Arrangement Act Proceedings

2.1.1 Initial Orders

The Initial Order granted in CCAA proceedings has become "standardized" and Model or Template Initial CCAA Orders have been adopted in many provinces. The CBA Sections endorse the consolidation of the BIA, CCAA and the *Winding-up and Restructuring Act* (WURA) into a single Insolvency Act applicable to all insolvent liquidation (bankruptcy or liquidation/winding-up) and reorganization proceedings.

To streamline CCAA proceedings, we recommend proceedings under the consolidated act (or the CCAA if there is no consolidation) be commenced by an administrative filing akin to the Notice of Intention to Make a Proposal under Part III, Division I of the BIA. There is no demonstrated need for costly applications to a court for an initial order under the CCAA. We also recommend that the consolidated act (or the CCAA) specify the relief that would automatically arise on the commencement of CCAA proceedings with any additional relief being available only on application to the court after the CCAA proceeding is commenced.

2.1.2 Claims Process

We share the concerns on the cost of CCAA proceedings. For determination of claims, the CCAA provides that: the quantum of a creditor's claim is determined by reference to the BIA or WURA; and, if a claim is disputed by the debtor, the quantum of a claim is determined by the court. While procedures to determine disputed claims vary in practice, the basic process tends to be consistent and provides for: filing proofs of claim; review and initial determination of claims by the monitor or a claims officer; and appeals to the court from the decision of the monitor or claims officer.

The CBA Sections support the consolidation of the BIA, the CCAA and WURA into a single Insolvency Act. A consolidated Act would include a procedure to determine disputed claims.

Consideration should be given to a claims process for the debtor to identify the claims and the quantum it will accept, and for creditors to be required to take steps only where they are not identified by the debtor as a creditor or they disagree with the quantum of their claim identified by the debtor.

2.1.3 Court Applications

The CCAA reorganization regime should not be based on a few high-profile CCAA proceedings. The amount of litigation in certain CCAA proceedings is often the result of the complexity of the proceeding and the issues involved, rather than the reorganization simply proceeding under the CCAA. Complex insolvency proceedings, whether under the CCAA or BIA, will often be litigation-intensive and, for that reason, expensive.

The CBA Sections do not oppose the monitor taking on a more active role in the CCAA proceedings. However, professional fees of the monitor and its advisors are a significant part of the cost of litigation. In many CCAA proceedings the role of the monitor has evolved and expanded to the point that the monitor is involved in the debtor's day-to-day business.

We do not support the role of the monitor expanding to include the resolution of substantive disputes between stakeholders in the reorganization process. The function of the monitor is to be the eyes and ears of the court, oversee the CCAA process, and provide information to the court and creditors.

Authorizing steps to be taken by the debtor with the consent of the monitor will not necessarily reduce the frequency of court attendance in complex reorganization proceedings. Even where summary procedures are available, stakeholders often seek the court's stamp of approval. We believe, however, that certain matters should not necessarily require seek court approval. For example, where other parties to an agreement do not object to the assignment of the agreement, there should be no need for an order authorizing the assignment.[12]

2.2 Balancing Competing Interests

2.2.1 Role of Unsecured Creditors

Given the role played by the monitor and the proposal trustee, we do not believe it is necessary to mandate the appointment of a committee of creditors funded by the debtor. Every effort

[12] See BIA, ss. 84.1 and 66, and CCAA, s. 11.3

must be made to ensure that monitors and proposal trustees are and appear to be independent to ensure all stakeholders have confidence in the reorganization regime. The CBA Sections recommend considering whether the appointment of the monitor or proposal trustee should be subject to approval by creditors early in the reorganization proceeding.

2.2.2 Acting in Good Faith

The CBA Sections do not support including in the CCAA (or the BIA) an obligation on parties to act in good faith. An obligation on stakeholders, particularly creditors, to act in good faith will give rise to more litigation and increase the cost of CCAA proceedings.

In any negotiation, a party taking a position they know may have little chance of success may not necessarily be acting in bad faith. Courts also maintain jurisdiction to sanction creditors who are seen to act in bad faith.

2.3 Professional Fees in CCAA Proceedings

The CBA Sections are concerned with the escalating cost of insolvency proceedings and have identified a number of options to control their cost. While high professional fees are not restricted to the CCAA, the situation appears particularly acute in proceedings under the CCAA where they have become a major deterrent. The high cost of reorganizing under the CCAA not only erodes creditor recoveries, but calls into question whether a reorganization will provide higher recoveries than a liquidation, particularly where the reorganization is premised on the sale of the debtor's assets and business.

One solution may be a mandatory review process conducted by a referee or specially appointed court officer who would have to review and approve all professional fees. Alternatively, a tariff or guideline could be adopted. In addition, eliminating the requirement for a court application to commence CCAA proceedings and restricting the need to apply to the court for extensions of the time for filing a proposal in proceedings under Part III, Division I of the BIA will reduce the cost of reorganization proceedings under the BIA and the CCAA.

We recommend that, in addition to the fees of the insolvency administrator and its counsel, professional fees of all stakeholders paid by the debtor be subject to approval by the court.

2.4 Enhancing Transparency

2.4.1 Creditor Lists

The CCAA requires that the monitor prepare a list of creditors and make that list publicly available.[13] It is also common practice for the monitor (or the debtor) to maintain and publish a service list identifying stakeholders actively participating in the CCAA proceeding. The Sarra Report[14] indicates that some stakeholders suggested maintaining a list of creditors that would show, at any time, what the economic interests were underlying the claims against the debtor.

The CBA Sections do not believe that any increase in transparency that would result from maintaining a list of creditors would justify the cost of maintaining the list. Consideration should also be given to the cost in maintaining a creditor list in the context of larger CCAA proceedings involving perhaps thousands of creditors.

2.4.2 Empty Voting and Disclosure of Economic Interests

The theory underlying class voting is that creditors should be classified based on commonality of interest to consult together and, absent bad faith, to freely vote based on commonality. Where creditors with different interests vis-à-vis the debtor are combined in a class, the majority having common interest) may potentially impose their views on the minority. Care must be taken to ensure that the classification of creditors does not provide creditor(s) with a veto and prejudice an otherwise viable plan or proposal.

A person who acquires or subrogates to a claim may not necessarily have the same interests vis-à-vis the debtor as the original creditor. How this impacts the dynamics of the reorganization depends largely on the classification of creditors for the purpose of voting on the plan (or proposal). Where, for example, a person who acquires the claim of a supplier at a discount with the hope of making a profit is included in a class comprised of creditors whose primary interest is the continued relationship with the debtor, the person will likely be unable to realize the intended objective unless placed in a separate class of creditors.

[13] CCAA, s. 23(1)(a).

[14] Dr. Janis Sarra, *Examining the Insolvency Toolkit: Report of the Public Meetings on the Canadian Commercial Insolvency Law System*, 2012 [Sarra Report]. Available online at: www.insolvency.ca/en/iicresources/resources/Examining_the_Insolvency_Toolkit_Dr._J_Sarra_2012.pdf

2.5 Role of the Monitor

2.5.1 Pre-Filing Reports

The CCAA does not specifically contemplate the monitor preparing a pre-filing report to the court. In Ontario, however, that has become practice for the proposed monitor. In many cases, the debtor's application for an Initial Order under the CCAA is brought on limited notice to stakeholders. We question the need for a pre-filing report. Applications under the CCAA are generally supported by affidavit evidence and must include a cash flow statement that has been reviewed by the monitor and the debtor's most recent financial statements. In our view, the utility of pre-filing reports must be balanced against the cost incurred to prepare them.

We recommend that the BIA, CCAA and WURA be consolidated into a single Insolvency Act and that proceedings under the CCAA be by way of a regulatory filing akin to a Notice of Intention to make a Proposal. This would eliminate the need for a pre-filing report. If these recommendations are not adopted, we believe that the information in a pre-filing report should be prescribed based on the relief being sought by the debtor on the initial application.

2.5.2 Conflict of Interest

The existence and extent of any pre-filing relationship(s) with the debtor or key stakeholders should be required to be disclosed by the monitor.

2.6 Asset Sales

2.6.1 Credit Bidding

A secured creditor should be permitted to bid its debt to acquire the property subject to its security. Any issues about the imbalance of power in favour of secured creditors will not be addressed by restricting credit bidding.

The Court has jurisdiction to impose conditions on credit bidding that can address any imbalance of power that may exist in a particular situation to ensure that the sales process is fair and transparent.

2.6.2 Stalking Horse Bids

We believe that stalking horse sales processes are, in certain circumstances, an appropriate way for assets to be sold in an insolvency. However, the CBA Sections do not believe that it is necessary or desirable for the CCAA or the BIA to expressly authorize any particular form of sales process. The CCAA and BIA establish the criteria to be applied by the court in determining whether to approve a sale rather than specify what type of sales process may be employed.

2.6.3 Applicability of Asset Sale Test

The CCAA and BIA require the debtor to obtain court approval for all out-of-the-ordinary course property sales, no matter what the value of the property. In some cases, the cost of seeking approval may exceed the value of the property. The CBA Sections do not oppose a rule that the sale of property to third parties with an aggregate appraised value less than a given amount does not require court approval, provided the transaction is approved by the monitor or proposal trustee.

2.7 CBCA Arrangements

The *Canada Business Corporations Act* (CBCA) arrangement provisions are employed by debtors due to streamlined nature of the process compared to a CCAA proceeding.

The CBCA arrangement provisions should be used to affect balance sheet restructurings of insolvent corporations. CBCA balance sheet restructurings are perceived by the marketplace as an attractive alternative to the CCAA and BIA. The CBCA restructuring process has advantages over a CCAA or BIA restructuring process in that it is generally cheaper (no court appointed officer, shorter process), faster (as little as 30 days), and does not involve all the creditors (just debt and equity). In addition, equity holders have a greater chance of preserving some value. The CBCA is used to implement a strictly financial restructuring.

Case law has evolved to explicitly recognize the legitimacy of using s. 192 as a means for insolvent companies to restructure debt. The cases are limited to securities that are debt obligations, not generally trade debt or other liabilities. Courts have conclusively determined that s. 192 is an appropriate way to restructure debt and have allowed insolvent companies to avail themselves of s. 192 where one or more parties applying for court approval were solvent or where the insolvent applicant would be solvent after completing the arrangement. Finally, courts have shown the same level of pragmatic flexibility in applying discretion similar to the exercise of CCAA discretion to enable companies to obtain CCAA-like remedies, such as a stay of proceedings, no default orders and continued supply orders.

Though CBCA arrangements may provide a desirable alternative, in our view the CCAA affords more robust protections to creditors. CCAA proceedings need not be more expensive than a

CBCA arrangement designed to accomplish the same objective, particularly if provisions are added to the CBCA arrangement proceedings to protect the interests of creditors.

2.8 Streamlined Small Business Proposal Proceeding

We recommend amending Part III of the BIA to include a Division III, which would apply to an insolvent person or bankrupt, other than individuals, where the claims against the person do not exceed $500,000. The CBA Sections recommend that the Division III process provide strict timelines for the filing of a proposal, and provisions similar to Division II for the meeting of creditors to consider the proposal and court approval of a proposal that has been accepted (or deemed accepted) by creditors.

2.9 Division I Proposals Extension

The CBA Sections support amending the BIA to give the court jurisdiction, in appropriate circumstances, to provide a debtor subject to proceedings under Division I more than six months to file a proposal. However, in practice, it is rare for the Court to allow a debtor subject to proceedings under Division I with the full six months to file a proposal. In addition, where a debtor requires additional time to obtain creditor approval, it is possible for the debtor to seek to have the proceeding taken up and continued under the CCAA or, as noted in the Sarra Report, file what is often referred to as a “holding” proposal.

A significant issue with the extension of the time for filing a proposal under Part III, Division I relates to the test that must be satisfied for an extension to be granted. In 2009, the BIA was amended to give the Court jurisdiction to approve interim sales of property by a debtor subject to proceedings under Division I.

The jurisdiction to permit a debtor more than six months to file a proposal would be limited to complex commercial proceedings. The ability of the Court to grant longer extensions in complex restructurings could be addressed in a consolidated Insolvency Act.

The CBA Sections share the concerns identified in the Sarra Report on the cost of attendances to extend the time for a debtor to make a proposal under Division I. We recommend considering amending the BIA to extend the maximum 45 day extension to 60 days, and require that, after the initial extension, the debtor apply for an extension only if required to do so by X creditors representing Y percentage of the claims in writing no less than Z days prior to the expiry of the period, failing which the time for making a proposal would be automatically extended for an additional 60 days. To ensure that creditors are kept apprised of the debtor’s financial circumstances, we recommend that the proposal trustee be required to post a comparison of the debtor's actual and projected cash flow on a monthly basis.

2.10 Liquidating CCAA Proceedings

The 2009 amendments to the CCAA (and BIA) gave the court jurisdiction to approve out-of-the-ordinary-course sales of property by the debtor prior to a plan or proposal being put to creditors. We do not believe the CCAA (or BIA) needs to prescribe criteria to be considered by the court in authorizing a debtor to engage in a process to market its property for sale.

The debtor is currently not required by the CCAA (or BIA) to obtain approval in advance of marketing its property for sale, but only the actual sale of property.

There continues to be some concern among stakeholders about the use of the CCAA (or the BIA) as a means to liquidate the debtor's property for the benefit of secured creditors, particularly given the cost of CCAA proceedings. The duties of the monitor in a CCAA proceeding include the obligation to report to the court if the monitor believes it would be more beneficial to the creditors if the proceedings were taken under the BIA. We recommend that this obligation be amended to include whether it would be in the interests of creditors that the proceeding be converted to a receivership. The same obligation should be imposed on proposal trustees.

3. Enhancing Equity

3.1 Employees' Claims

The CBA Sections do not have access to the data required to assess whether existing priority claims provide reasonable protections to employees or how any increase in the quantum of the priority claims would impact the ability of employers to secure financing or other credit.

3.2 Employees' Claims in Asset Sales

The current BIA and CCAA provide that the court can only approve a sale of property by the debtor if it is satisfied that the debtor can and will make the payments for employee remuneration and pension-related obligations that would have been required had the court approved a plan or proposal.

The assignment of agreements provisions of the BIA and CCAA do not include the payment of employee or pension-related claims. While in many cases the assignment of agreements will be part of a sale of other assets, in some circumstances it will be affected independent of the sale of other assets. We recommend that the BIA and CCAA be amended so the assignment of agreements parallel the sale of assets provisions and require the court be satisfied that employee and pension-related claims can and will be paid.

3.3 Hardship Funds

It is not necessary to include specific jurisdiction to authorize the debtor to make hardship payments to creditors (or employees) or impose limits on the court's jurisdiction to make an order authorizing (or directing) a hardship payment in the CCAA or BIA. The matter should be left to the court to determine on a case-by-case basis. Neither the BIA nor CCAA prevent or restrict a debtor from making payments to a creditor.

The ability to pay an interim dividend under the BIA is limited to bankruptcy proceedings. In proposal proceedings any payments made to creditors will be determined by the terms of the proposal and the court has no explicit jurisdiction to order the debtor to pay a creditor. A proposal (or plan) may be structured so that creditors in a class receive no cash distribution. A proposal (or plan) can, for example, provide for the distribution of shares in full and final satisfaction of a creditor's claim.

3.4 Third Party Releases

The jurisdiction of the court to grant releases to third parties should be codified. We recommend that third-party releases be available only where:

- the parties to be released are necessary and essential to the restructuring;
- the claims to be released are rationally related to the purpose of the plan and necessary for it;
- the plan cannot succeed without the releases;
- the parties having the claims against them released were contributing in a tangible and realistic way to the plan; and
- the plan benefits the debtor and creditors generally.

We also recommend that the court be required to consider those creditors whose claims are being released: (a) in connection with the classification of creditors for the purpose of voting on a plan; and (b) when approved a plan.

3.5 Key Employee Retention Bonuses

The CBA Sections recommend that the BIA and CCAA prohibit awarding bonuses or key employee retention payments to directors, officers or employees who are related to the debtor (or directors or officers of the debtor) except with court approval. The court should be empowered to authorize bonuses to those individuals only where it is established that the payments to be made are reasonable and necessary for the reorganization. The monitor or proposal trustee should be required to prepare a report on the proposed bonuses and the motion seeking approval for any bonuses should be on notice to all creditors. We do not believe, however, that bonuses or adjustments to an employee's salary during a restructuring that raise the employee's compensation up to 25% of their ordinary pay should require court approval.

The BIA or CCAA should not make officers and directors personally liable for employee remuneration, including any bonuses. The BIA and CCAA do not currently impose personal liability for employee remuneration on directors or officers. We recommend, however, that the court be given jurisdiction to grant a priority charge to secure any authorized bonuses.

3.6 Oppression Remedy

The CBA Sections are opposed to any amendments that would limit the ability of creditors to take advantage of a statutory right provided for their benefit. In our view, there is no justification for limiting or removing the right of creditors or a bankruptcy trustee from seeking an oppression remedy. Both the BIA and CCAA state that stakeholders will have access to the oppression remedy provisions of any applicable corporate legislation. The BIA and CCAA prohibit the compromise of oppression claims against the directors of a reorganizing corporation.

3.7 Interest Claims

The BIA provides that where a surplus is available after the principal amounts of the unsecured claims against a bankrupt are paid in full, that surplus should be applied to pay interest to creditors at a rate of 5%. We believe there should be consistent treatment of interest claims in all insolvency proceedings under the BIA and CCAA.

3.8 Unpaid suppliers

Section 81.1 does not provide effective protection to suppliers who supply goods to a debtor immediately prior to the commencement of reorganization under the BIA or CCAA. There continues to be concern with respect to the debtor building up inventory levels in advance of the commencement of reorganization proceedings. We believe that the BIA and CCAA should be amended to ensure that suppliers who provide goods to a debtor within a certain period prior to the commencement of a reorganization proceeding receive payment on a priority basis.

The application of s. 81.1 to circumstances where an Interim Receiver has taken possession of the debtor's property should be clarified. While the intention of the 2009 amendments was to limit the appointment of Interim Receivers, in practice the situation still exists where interim receivers are being appointed to take possession of and to liquidate assets. S. 81.1 should be applicable in those circumstances.

3.9 Fruit and Vegetable Suppliers

The CBA Sections believe that Canada should comply with any international obligations, but there is no obligation to enact provisions that parallel the US *Perishable Agricultural Commodities Act* (PACA).[15] The provisions of the BIA dealing with unpaid farmers, fishers and aquaculturists fairly balance the interest of stakeholders and appear to provide treatment that is comparable to the PACA.

4. Deterring Fraud and Abuse

4.1 Director Disqualification

The ability of individuals to sit as directors of corporations is a matter for corporate and securities legislation. The CBA Sections do not believe it is appropriate for federal insolvency legislation to address whether an individual can sit as a director of a solvent corporation.

4.2 Related Party Subordination and Set-Off

The objective of the claims process in an insolvency proceeding is to determine whether a person has a legitimate claim against the debtor.

[15] 7 U.S. Code Chapter 20A – Perishable Agricultural Commodities. Online at: www.gpo.gov/fdsys/pkg/USCODE-2011-title7/pdf/USCODE-2011-title7-chap20A.pdf

In our view, it is not appropriate to deny a person who has a legitimate claim or set-off right the ability to recover that claim (or exercise the set-off right) on the basis only that the creditor is related to the debtor. The BIA and CCAA restrict the ability of related creditors to vote in favour of a proposal or reorganization plan,[16] but do not address the ability of a related person to recover a claim against the debtor or to exercise set-off rights to reduce amounts otherwise payable to the debtor.

The creditors of an insolvent debtor can, as a result of claims made or set-off rights exercised by related persons, find their recoveries against the debtor reduced. However, denying a related person the ability to make a legitimate claim or exercise legitimate set-off rights against a debtor can have an adverse impact on the ability of the creditors of that related person to recover against the related person.

5. Cross-Border Insolvencies

5.1 Foreign Claims under Long-Arm Legislation

While there is potential unfairness to stakeholders in recognizing a claim against a Canadian debtor based on pension-related obligations to employees of a related foreign corporation, we question whether the BIA and CCAA should impose a blanket prohibition on the recognition of any claims based on long-arm pension or other legislation. This prohibition may have unintended consequences in the context of a cross-border insolvency involving a globally integrated group of companies.

Consideration should be given to amending the BIA and CCAA to give the court jurisdiction to determine whether claims against a debtor arising under a foreign law and not related to any obligations of the debtor ought to be recognized. The court could then consider a claim in its factual context and determine whether it is appropriate to recognize the claim against the debtor in the Canadian proceeding.

5.2 Set-Off for Claims in Multiple Jurisdictions

Some stakeholders have suggested that in situations where a creditor has claims in multiple jurisdictions where the debtor has commenced insolvency proceeding for the same debt, and that creditor has successfully recovered amounts for post-filing interest in any foreign

[16] BIA, s. 54(3) and CCAA, s. 22(3).

jurisdiction, these amounts should be deducted from the principal amount of the creditor's claim under the BIA or CCAA.

We question how pressing or significant an issue this is in cross-border insolvencies and whether specific amendments to the BIA and CCAA are needed to address the matter.

5.3 Allocation of Proceeds

In our view, the allocation of proceeds must be addressed on a case-by-case basis and it is not necessary or possible for the BIA to provide guidance to insolvency practitioners on how to address specific factual scenarios they may encounter in administering a cross-border insolvency.

5.4 Treatment of Enterprise Groups

The CBA Sections recommend that Canada wait for the results of the UNCITRAL group working on the treatment of enterprise groups in cross-border insolvency prior to making any amendments to the BIA or CCAA.

5.5 Centre of Main Interests

It is not clear how the recognition of a foreign jurisdiction as a Canadian debtor's centre of main interest (COMI) could reduce the ability of smaller creditors to participate in an insolvency proceeding involving the debtor. The ability of creditors to participate in insolvency proceedings are external to the issue of COMI. In a cross-border insolvency involving a Canadian debtor where proceedings are pending in a foreign jurisdiction, the key issues relate to what proceedings are (or may be) commenced in Canada in respect of the debtor, and the cooperation between and the coordination of proceedings. The ability of creditors to participate in that process is not necessarily linked to what jurisdiction is the debtor's COMI.

A debtor's COMI is legally relevant only to determine whether the foreign proceeding is a foreign main proceeding or a foreign non-main proceeding. The only issue that turns on COMI is whether there is an automatic or mandatory stay imposed. Even where a proceeding is recognized as a foreign non-main proceeding, a stay of proceedings will generally be imposed by the court on recognition. The key impact for creditors is the restriction on the ability to commence plenary proceedings in Canada where a foreign proceeding is recognized under the

CCAA. The fact that a proceeding has been identified as a foreign main proceeding does not impact the ability of Canadian creditors to participate in the Canadian or foreign proceeding.

Where Canadian creditors receive notice in advance of the recognition of a foreign jurisdiction as the COMI of a Canadian debtor, the CBA Sections believe that all stakeholders should have the opportunity to make submissions on the recognition of a foreign proceeding and the relief being sought. Amendments to the UNCITRAL Model Law[17] made by Canada in 2009 removed the provision contemplating interim relief in connection with the recognition of a foreign proceeding pending a full hearing on notice to stakeholders.

5.6 Unsecured Creditors' Committees

The discussion paper does not identify any specific instances where an unsecured creditors' committee (UCC) has improperly participated in a Canadian insolvency proceeding or where the participation of a UCC in a Canadian insolvency proceeding has improperly increased costs as a result of litigation by the UCC. The CBA Sections are concerned about a policy decision based on anecdotal evidence or broad assumptions.

There are three possible scenarios where the recognition and participation of a UCC must be considered: the recognition in Canada of the foreign proceeding in which the UCC was appointed; Canadian proceedings under the BIA or CCAA in respect of a debtor that are parallel to foreign proceedings in which the UCC was appointed; and the Canadian proceedings under the BIA or CCAA involving a debtor where the debtor in respect of which the UCC has been appointed is a stakeholder, a creditor or shareholder.

UCCs play an important statutory role in the insolvency process in the US. It would not, in our view, be appropriate to adopt general principles and criteria for the recognition of foreign UCCs in Canadian insolvency proceedings or to define the scope of UCC participation in Canadian insolvency proceedings. The court has adequate tools to ensure that the participation of UCCs in Canadian insolvency proceedings does not become disruptive or result in other stakeholders incurring unnecessary costs. We do not support legislative barriers on the ability of UCCs to participate in Canadian insolvency proceedings.

[17] Model Law on Cross-Border Insolvency with Guide to Enactment and Interpretation, United Nations Commission on International Trade Law (UNCITRAL), 2014. Available at: www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf.

VIII. ADMINISTRATIVE ISSUES

1. Renaming the Bankruptcy and Insolvency Act

The CBA Sections do not object to the BIA being renamed the Insolvency Act. Amending the name would be particularly appropriate for a single unified insolvency statute or to codify the law on receivers appointed over insolvent debtors. The CBA Sections do not support the removal of the reference to "bankruptcy" from the BIA. The social stigma associated with the term bankruptcy is an important aspect of the insolvency process and provides incentive for debtors to attempt to resolve their financial issues through other means, such as proposals under Part III of the BIA.

In addition, the title "trustee in bankruptcy" is not used in the BIA. The general term used by the BIA is simply "trustee". When acting as trustee of a bankruptcy estate, the trustee's title is "trustee of the estate of X, a bankrupt".

2. A Unified Insolvency Law

The CBA Sections support the unification of the BIA, CCAA and WURA into a single insolvency statute. There is no compelling reason to maintain multiple insolvency laws. After the 2009 amendments to the BIA and CCAA, the practical differences between their reorganization regimes are limited.

Some provisions of the CCAA, however, are intended to facilitate the reorganization of larger, more complex businesses. The six month limitation on the ability to make a proposal may not be appropriate where the debtor has a large number of stakeholders. We believe that any necessary distinctions on the relief available to debtors based on size can be accomplished in a consolidated Insolvency Act by differentiating where the total claims against the debtor and any affiliated companies exceed $5M.

There is no reason to restrict the exercise of broad discretion or inherent jurisdiction to reorganizations involving corporations or trusts with large debts. The amount of debt owing is not indicative of the complexity of the debtor's business or operations. In some cases CCAA proceedings have commenced where debtor companies have very few creditors and no business operations.

Merging the BIA and CCAA would present an opportunity to address the ever-increasing cost of the CCAA insolvency regime by eliminating the requirement for the debtor to apply to the court seeking to commence CCAA reorganization proceedings. We do not believe it is necessary for the debtor to apply to the court to obtain a stay of proceedings and the benefit of the CCAA reorganization regime.

3. Restricting Consumer Proposals

We do not believe there is any compelling reason why business debt cannot be accommodated in a Division II proposal. Attempting to differentiate between "consumer debt" and "business debt" would give rise to unnecessary and expensive litigation and would make it more difficult for individuals to reorganize, forcing more individuals into bankruptcy.

4. Special Purpose Entities – Trust

We do not oppose the broad application of the BIA and CCAA to trusts. However, the liquidation or reorganization of business structures such as trusts and partnerships can be more complex than that of an individual or corporation. The application of the BIA and CCAA to trusts and partnerships should be reviewed to ensure that any necessary modifications to the legislation are made.

5. Receiverships

5.1 Codification of Receiverships

The CBA Sections support the amendments to codify the powers of a receiver defined by s. 243(2) of the BIA. A unified Insolvency Act should address the appointment of receivers over the property of an insolvency debtor as well as the powers and responsibilities of a receiver appointed over the property of an insolvent debtor.

5.2 No Action against Receivers without Leave of Court

We support the amendment of s. 215 of the BIA to include receivers within the meaning of s.243(2) of the BIA.

6. Marshalling Charges

The CBA Sections do not, in theory, oppose amending the BIA to provide for the application of marshalling in favour of the trustee to permit the court, on the application of the trustee, to require a secured creditor with recourse of multiple pools of assets resort to those pools in a manner that maximizes the property available to creditors.

The BIA does not expressly provide for marshalling among secured creditors. However, marshalling may be applied between secured creditors. The BIA provides for the property of the bankrupt to vest in the trustee[18] and for the proceeds from the realization of the property of the bankrupt to be distributed by the trustee[19] subject to the rights of secured creditors. Generally, secured creditors take steps to realize on their collateral outside of the bankruptcy. The doctrine of marshalling does not cease to apply between secured creditors where the debtor is bankrupt and will be applied between secured creditors notwithstanding that the debtor is bankrupt.[20]

The issue that arises in a bankruptcy is whether marshalling can apply in favour of unsecured creditors or the trustee. For example, can marshalling be applied to require a secured creditor with recourse to another debtor to recover against that debtor before proceeding against the property of the bankrupt? Marshalling is not applied in favour of a creditor that does not have an interest in the debtor's property, i.e. an unsecured creditor.[21]

In *Ledco Limited (Re),*[22] the Ontario Court had jurisdiction to apply the doctrine of marshalling, but determined that marshalling did not apply in favour of the unsecured creditors of the bankruptcy estate and suggested that an amendment to the BIA was required. The case involved a request by creditors for a determination that the doctrine of marshalling was not applicable among secured creditors in a bankruptcy and that they were third parties whose interests would be adversely impacted. The court found that marshalling did apply among secured creditors in a bankruptcy and that creditors were not third parties for the purposes of the application of marshalling.

The application of other equitable remedies can mitigate against the fact that marshalling is not available in favour of the trustee. Where, for example, the trustee pays a debt where the bankrupt is co-liable, equity will act to subrogate the trustee to the creditor's rights against the co-debtor permitting the trustee to recover against the co-debtor for the benefit of creditors.

[18] BIA, s. 71

[19] BIA, s. 136(1)

[20] See *Ledco Limited (Re),* 2008 CanLII 53857 (ON SC).

[21] See *Allison (Re),* 1995 CanLII 7146 (ON SC) aff'd, 1998 CanLII 3766 (ON CA), (1998). Note that in *Governor and Company of the Bank of Scotland v. Nel (The)*, [1998] 4 FC 388 the court took a broader view of marshalling and indicated that it was applicable to at least the holders of in rem interests in the debtor's property.

[22] 2008 CanLII 53857 (ON SC)

In those circumstances, the application of marshalling would apply to permit the court to effect the same result without requiring the trustee to take proceedings against the co-debtor.

7. Tax Issues

Our comments respond to the questions in the consultation paper.

a) Whether a restructured tax debtor with prior tax obligations should be allowed "fresh start accounting" for tax purposes – specifically those resulting from debt forgiveness – being dealt with as "pre-filing claims".

We are of the view that tax debt arises as a result of the compromise of claims against a debtor should be subject to compromise in a plan or proposal.

b) Whether tax authorities should be required to send a notice in accordance with section 244 of the BIA before issuing enhanced requirements to pay.

We support amending s. 244 of the BIA to require advance notice by any person who wishes to enforce any right over all or substantially all of the specific property of an insolvent debtor to satisfy a debt claim. The primary purpose of requiring secured creditors to provide notice pursuant to s. 244 of the BIA is to ensure that an insolvent debtor has time to take steps to protect its interests and those of its other stakeholders before a secured creditor takes steps to enforce its security over all or substantially all of the debtor's accounts. In our view, there is no practical difference between issuing an enhanced garnishment, which effects a transfer of the ownership of all or substantially all of a debtor's accounts, and enforcing a security interest over all or substantially all of a debtor's accounts.

c) Whether account receivables that are the object of pre-filing enhanced requirements to pay should "re-vest" in the estate.

We do not support re-vesting accounts in a debtor on filing a Notice of Intention to Make a Proposal or a Proposal in circumstances where CRA has done everything required to effect the transfer of title to the account(s). This would be akin to returning property to the debtor subject to a security interest where the secured creditor had taken all necessary steps to enforce its security prior to filing a Notice of Intention to Make a Proposal or a Proposal. The BIA should not reverse valid steps taken by a creditor with an interest in the debtor's property.

The CBA Sections would, however, support amending the BIA to provide that an involuntary transfer of title may be a preference or transfer at undervalue.

IX. TECHNICAL ISSUES

1. Section 197 - Costs Against the Debtor

Courts already have jurisdiction under s. 197(1) of the BIA to award costs against a debtor in connection with a discharge hearing. It provides that the costs of and incidental to any proceedings are in the discretion of the court. There is no need to provide specific jurisdiction to award costs against a debtor in connection with a discharge hearing.

2. Section 204.3 – Losses Due to Bankruptcy Offences

The CBA Sections support an amendment to s. 204.3(1) of the BIA to clarify that the court has jurisdiction to make an order compensating a person who is the victim of a bankruptcy offence or the estate for any damage or loss. The *Criminal Code* imposes restrictions on the restitution orders that may be made in connection with an offence under that Act and consideration should be given to whether the provisions of the BIA should parallel the *Criminal Code*.[23]

3. Disallowance of Claims

We do not oppose amending s. 135(4) to remove the requirement that a person whose claim has been determined or disallowed by the trustee pursuant to s. 135(1.1) or (2) seek to extend the 30 day appeal period. Courts have generally adopted a flexible approach to extensions of time, with a focus on prejudice.

4. Securities Firms Bankruptcies

The CBA Sections do not oppose amending the BIA to permit securities regulators or customer compensation bodies to bring an application under s. 43 in respect of securities firms subject to Part XII. The BIA provisions on bankruptcy applications will have to be modified to account for securities regulators. Provisions on customer compensation bodies will have to be developed. The requirement that the debtor owe $1,000 and have committed one of the acts of bankruptcies in s. 42 may have to be modified to reflect the policy basis for permitting securities regulators and customer compensation bodies to bring bankruptcy applications against a securities firm.

[23] See *Criminal Code*, R.S.C. 1985, c. C-46, ss. 738 – 741.

5. Preview of Proposals by the Trustee

We are concerned about legislative changes being driven by anecdotal reports. There are no restrictions on the ability of a trustee to conduct investigations or inquiries on a debtor's financial situation prior to accepting to act as trustee under a proposal or Notice of Intention to Make a Proposal. It is unclear what legislative changes could be made to address the fact that some trustees may not undertake sufficient due diligence prior to accepting an engagement or not ensuring that they are properly protected in terms of recovery of professional fees.

6. Section 173 - Facts for which Discharge will be Suspended

The purpose of s. 173 of the BIA is to identify circumstances where the court is not able to grant an absolute discharge. Where a fact listed in s. 173 is proven, the court's jurisdiction is limited to refusing to discharge the bankrupt, or granting a suspended or conditional discharge. Section 173(1) is intended to identify pre-bankruptcy conduct worthy of sanction. In our view, the facts in s. 173(1) should be reviewed to ensure that they reflect the type of conduct that ought to deny an absolute discharge.

Section 173 is also relevant in proposal proceedings under the BIA. Where any of the facts in s.173 are proven against a debtor who has made a proposal, the court cannot approve the proposal unless it provides reasonable security for the payment of not less than 50 per cent of the unsecured creditors or another percentage the court may direct.[24] When determining whether to approve a proposal, we believe the court should consider the ability of the debtor to perform a proposal, the recoveries to creditors, and the assurances that creditors have that any payments required by a proposal will be made by the debtor. However, we question the linkage between those considerations and the facts listed in s. 173(1).

Where a bankruptcy is opposed based on two of the grounds listed in s. 173(1) –failure to pay surplus income or the fact that the debtor could have made a viable proposal – the requirement for mandatory mediation is triggered. We question whether this ought to trigger mandatory mediation.

7. Secured Creditors Calling Proposal Meetings

The CBA Sections believe that if creditors who have proven unsecured claims representing an aggregate value of at least 25% of the value of the proven unsecured (or secured) claims

[24] BIA, s. 59(3).

request a meeting, the administrator should be required to call a meeting to consider the Consumer Proposal.

We believe that calling a meeting under s. 66.15(2) should be based on the creditors to whom the proposal is being made, so the creditors whose claims will be compromised can, if a sufficient number desire, have a meeting to formally vote on the proposed compromise. While Part III, Division II proposals are made to creditors generally, the form of Consumer Proposal (Form 47) provides for different treatment for secured and unsecured creditors. It is our understanding that Consumer Proposals are not generally made to secured creditors as their claims tend not to be compromised by the Consumer Proposal and are generally paid outside it.

X. OTHER ISSUES

1. Tolling of Limitation Periods

The BIA does not contain a limitation period. However, in *Edwards Estate v. Food Family Credit Union,*[25] the Ontario Court of Appeal found that the general limitation periods in provincial statutes apply to bankruptcy proceedings and proceedings by bankruptcy trustees to set aside transactions. In Ontario, for example, avoidance proceedings by a bankruptcy trustee are subject to a two year general limitation period that runs from the date of the bankruptcy.

A limitation period can have a significant impact on creditors in a bankruptcy. In *msi Spergel Inc. v. I.F. Propco Holdings (Ontario) 36 Ltd.*,[26] the Ontario Court of Appeal considered whether the stay that arises where a Bankruptcy Order is appealed has the effect of suspending the two year limitation period. The court found that it did not because the BIA did not provide for any extension or suspension of the limitation period during the time that the Bankruptcy Order was stayed. As a result, the avoidance proceeding, which had not been commenced until the appeal of the Bankruptcy Order was dismissed, was statute barred and creditors were denied the ability to challenge a $1.18 million payment by the bankrupt.

We do not believe there is a sound policy basis for applying a provincial limitation period to avoidance proceedings by a bankruptcy trustee under the BIA. The application of provincial limitation periods could result in avoidance proceedings available for the benefit of creditors in

[25] 2011 ONCA 497 (CanLII)

[26] 2013 ONCA 550 (CanLII)

lengthy CCAA proceedings being statute barred by the time a plan that permits the avoidance proceedings to be pursued is filed.

The United States Bankruptcy Code (USBC) provides for a suspension of otherwise-applicable limitation periods on the commencement of insolvency proceedings. Section 108(a) of the USBC extends the period to commence an action that the debtor could have taken before the filing of the bankruptcy petition for two years after the date of the bankruptcy filing, unless it would expire later under applicable non-bankruptcy law.

We recommend that both the BIA and CCAA be amended to make suspension of any limitation period applicable in avoidance proceedings available.

2. Claims Procedures – Employee Remuneration Charge and Pension Charge

The statutory charge in favour of employees to secure unpaid remuneration arising when a receiver is appointed allows claims to be established by filing a proof of claim in the prescribed form.[27] The Proof of Claim (Form 31) provides for filing claims where a Receiver is appointed and for claims by employees under the employee remuneration charge. Section 135 of the BIA does not provide for the determination of claims by a Receiver. We recommend that s. 135 of the BIA be amended to provide for the determination of claims filed against a debtor where a Receiver within the meaning of s. 243(2) is appointed over the debtor's property.

Similar provisions to secure pension-related obligations do not indicate how such claims are to be proven. The parallel provisions for employee remuneration claims require claims to be proven by way of a Proof of Claim in the prescribed form. We recommend that ss. 81.5 and 81.6 be amended to provide that claims under the pension charge will be established by filing Proof of Claim in the prescribed form and that Form 31 be amended accordingly.

3. Receivership as Initial Bankruptcy Event

In 2009, the definition of initial bankruptcy event (IBE) was expanded to include the commencement of proceedings under the CCAA. Transactions by the debtor during prescribed periods prior to the IBE may be attacked in a subsequent bankruptcy. Prior to 2009, the IBE was defined by reference to the commencement of proceedings under the BIA. The 2009 amendment was intended to eliminate the need for creditors to seek to have the stay imposed

[27] BIA, s. 81.4(8).

on the commencement of the CCAA proceeding in order to issue a bankruptcy application to trigger an IBE.

We recommend that the BIA be amended to provide that the appointment of a receiver in the meaning of s. 243(2) is an IBE. In many cases, the appointment of a receiver in the meaning of s. 243(2) represents the initiation of insolvency proceedings against the debtor and creditors should not be required to take steps to issue a bankruptcy application to trigger the avoidance provisions of the BIA where a receiver within the meaning of s. 243(2) is appointed.

4. Avoidance Proceedings in Reorganizations

The avoidance provisions of the BIA may apply in proposal proceedings under the BIA and CCAA reorganizations, unless the plan or proposal provides otherwise. However, these provisions may not operate as intended. The CCAA, for example, provides for transactions to be void against the monitor rather than the debtor.[28] We recommend reviewing the practical operation of these provisions and making any necessary amendments.

5. Restriction on the Exercise of Contractual Remedies in Bankruptcy

The BIA was amended in 2009 to restrict the exercise of contractual rights by parties to agreements with a bankrupt individual. These provisions do not, however, apply to contracts with a bankrupt corporation. At that time, the BIA was also amended to permit a bankruptcy trustee to assign the contractual rights and obligation of the bankrupt. The right to assign contractual rights and obligations is only of practical value to a trustee where there are restrictions on the ability of the other party to the contract to exercise contractual termination rights. The CBA Sections recommend that the BIA provisions applicable to agreements with bankrupt individuals be extended to apply to all bankrupts.

6. National Receiver – Charge for Operating Expenses

Section 47.2(2) of the BIA prohibits the court from granting a charge in favour of a national receiver to secure disbursements incurred by the receiver in operating the debtor's business. We see no rationale for this restriction. Where the receiver is empowered to operate the debtor's business, it should have a charge for any disbursements incurred. It is common practice, notwithstanding s. 47.2(2), to give a national receiver the ability to borrow money to

[28] CCAA, s. 36.1.

operate the debtor's business and to issue certificates secured by a priority charge over the debtor's property. We recommend that s. 47.2(2) be repealed.

7. Administration of Estate without Inspectors

Section 30 of the BIA was amended in 2009 to permit a bankruptcy trustee to perform the functions listed in s. 30(1) without inspectors where no inspectors are appointed. The CBA Sections recommend that the BIA be amended to give the trustee general authority to administer an estate without inspector approval where no inspectors are appointed.

8. Classification of Creditors

The CCAA was amended in 2009 to include criteria applicable to the classification of secured and unsecured creditors. Those criteria do not appear to be based on the same principles that have been developed by the court. Rather, they appear to be borrowed from s. 50(1.4) of the BIA. Section 50(1.4) relates to the classification of secured creditors only and the BIA does not prescribe any criteria for the classification of unsecured creditors, although it is possible for a proposal to divide unsecured creditors into classes.

Two fundamental concerns underlie the classification of claims for the purpose of voting on a plan or proposal. First, the rights of creditors should not be confiscated by the plan or proposal where the creditors are unfairly forced to accept an unreasonable compromise of their claims against the debtor. Second, creditors do not unfairly block the approval of a reasonable plan. The criteria specified in the BIA and CCAA address the first concern, but not the second.

The CBA Sections recommend that the classification of creditors provisions in the BIA apply to creditors generally, and the criteria in the BIA and CCAA be expanded to include factors identified by the court as relevant to the classification of creditors based on commonality of interest.

XI. CONCLUSION

The CBA Sections appreciate the opportunity to comment on Industry Canada's statutory review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*. We encourage further consultations with the public and interested stakeholders on specific proposed changes to the BIA and CCAA. We hope our comments will assist Industry Canada in amending and updating the legislation. We would welcome the opportunity to be of further assistance through future consultations, reviews or development of proposed legislation.

TAB 105

THE DOCTRINE OF

RES JUDICATA

IN CANADA

FOURTH EDITION

Donald J. Lange, B.A., LL.B., Ph.D. (Cantab.)

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rights. It did not decide an issue of fact or law fundamental to the guilt or innocence of the appellant on the first robbery charge.

Duhamel may be read narrowly or broadly. In a narrow reading, issue estoppel did not apply because the *voir dire* ruling was only a procedural matter of evidence at trial. A variation of the rule in *Talbot* applied, which is discussed later. There was no determination of substantive rights or issues between the parties whether or whether not that determination had to be interwoven in the final judgment. In this sense, *Duhamel* is in consonance with some aspects of the prevailing civil law of issue estoppel. In a broad reading, the first *voir dire* ruling determined a substantive issue between the parties. It was a final decision about the admissibility of a confession. What was fundamental to arriving at that decision was the finding of fact that the confession was not given freely and voluntarily. That decision did not have to be fundamental to another decision to give finality to it for the purpose of issue estoppel. It was not dependent on the final verdict of acquittal to give it finality. In this sense, *Duhamel* is not in consonance with prevailing law, such as *Bailey*, because the principles supporting the broad reading are implicitly rejected in *Duhamel*.

For the purpose of issue estoppel and cause of action estoppel, a decision on a motion must be rendered in a contentious matter. There must be at least two parties adverse in interest and there must be a decision in the first motion in favour of one party against another. One party must be vexed.[29] This principle may affect *ex parte* motions and *ex parte* applications.[30] However, an *ex parte* order has been held to be binding where no application is made to rescind or vary the order.[31]

Issue estoppel is a question of law on a motion.[32] When the court finds that the first motion bars the second motion, the effect is to render any finding by the second motions court of no binding consequence because the second motion is estopped.[33] There can be only one motion asking for the same relief.[34] Where there is no order made on the previous motion, a new motion for the same relief

[29] *Re Al-Smadi* (1994), 110 D.L.R. (4th) 750 (Man. Q.B.) at 754–55 regarding a second *ex parte* application under a statute.

[30] In *Fullowka v. Royal Oak Mines Inc.*, [1996] 6 W.W.R. 129 (N.W.T.S.C.), estoppel and abuse of process were not applied after an *ex parte* motion. There were several reasons, one of which was that the *ex parte* motion added the defendants, who then had all of the rights of the rules of civil procedure. Similarly, in *Iampen v. Royal Bank* (1987), 79 A.R. 305 (Master) at 312, the court held that an order made without notice to the proposed defendant does not create an issue estoppel precluding the defendant, once an action has been commenced, from applying to strike out the statement of claim because then the defendant has all of the rights of the rules of civil procedure. See also *Armaly v. Canada*, [2003] F.C.J. No. 1250 at par. 6 (F.C.).

[31] *Fraser v. Canadian Pacific Railway* (1908), 17 Man. R. 667 (K.B.) at 672; affd on this point (1908), 17 Man. R. 676 (C.A.) at 686; leave to appeal to S.C.C. refused (1908), 8 C.R.C. 205 at 222.

[32] *John Harvie Ltd. v. Grand Canyon Construction Co.* (1982), 16 A.C.W.S. (2d) 43 (Ont. H.C.) at 6.

[33] *Lundrigan Group Ltd. v. Pilgrim* (1989), 75 Nfld. & P.E.I.R. 217 (Nfld. C.A.) at 223.

[34] *J. F. Henderson Ltd. v. Athika Enterprises Ltd.* (1974), 5 O.R. (2d) 519 (H.C.) at 520.

TAB 106

Restitution in Private International Law

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categories of the *lex fori*.[24] The *lex fori* will characterise in accordance with its rules in a liberal manner, not insisting that all its technical requirements are complied with. This method of characterisation could be referred to as the "liberal" or "enlightened" *lex fori*. Therefore, under private international law, concepts such as "contract", "tort", "corporation" and "unjust enrichment" are to be given a liberal interpretation. For example, in *Re Bonacina*[25] the Court of Appeal characterised the matter before it as contractual even though the relevant foreign agreement was not supported by consideration.[26] Likewise, in *Batthyanay* v. *Walford*,[27] an action akin to waste, in relation to land situated in Austria and Hungary and subject to a *fidei commiss*, was characterised by the Court of Appeal as being in implied contract.[28] There was no indication that an Austrian court would have characterised it as such; something which at any rate would have been highly unlikely. Nor could it be confidently said that this foreign claim was on all fours with an English claim in implied contract. What is significant for present purposes, is that the Court of Appeal was not deterred by the fact that the particular foreign claim was not recognised under English law. It characterised it in accordance with what it considered to be the closest equivalent under the *lex fori*. Characterisation therefore is ultimately a question of substance and not of form. Although the selection of such issues or matters is determined by the *lex fori*, it is done so in a liberal manner.

2.2 The "Thing" to be Characterised?

It is submitted that there is also a third problem, which arises in relation to characterisation, possibly more fundamental than the two recognised by Cheshire and North. There is the inherent problem of determining the "thing" to be characterised. It is all very well to say that the *lex fori* is not to be applied strictly; however, a significant inquiry is isolating the thing to be characterised. This problem is particularly prevalent in relation to international restitutionary claims. It is not clear in fact whether it is the claim,[29] the rule,[30] the question,[31]

[24] *Macmillan Inc.* v. *Bishopsgate Investment Trust Plc (No.3)* [1996] 1 W.L.R. 387, 407, *per* Auld L.J. See also Cheshire and North, pp.38–9; Dicey and Morris, pp.38–43, 45–8, 1472; Kahn-Freund, pp.227–36.

[25] [1912] 2 Ch. 394.

[26] The same approach will presumably be adopted in relation to torts under s.9(2) of the Private International Law (Miscellaneous Provisions) Act 1995.

[27] (1887) 36 Ch.D. 269.

[28] There are strong arguments for doubting the correctness of the Court of Appeal's characterisation in *Batthyanay* v. *Walford*: see below ch. 7.3.3.

[29] Which can also be equated with the "cause of action": Cheshire and North, p.36; J. Bird, "Choice of Law" in F.Rose (ed.), *Restitution and the Conflict of Laws* (Oxford, 1995), p.75. In *Sayers* v. *International Drilling Co. NV* [1971] 1 W.L.R. 1176, 1181, Denning M.R. considered that one system of law must be applied to all the issues, including claim and defence.

[30] See *Re Cohn* [1945] Ch. 5, 7–8; *Re Maldonado* [1954] P. 223, 245, *per* Evershed M.R.

[31] *Ogden* v. *Ogden* [1908] P. 46, 57, 65, 74; *Beaudoin* v. *Trudel* [1937] 1 D.L.R. 216, 222, *per* Macdonnell J.A. (Ont.C.A.) ; *Re Maldonado* [1954] P. 223, 239, 244, *per* Evershed M.R. See also

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court on the ground that there was a real and substantial connection between the American Court and the subject matter of the proceedings and the plaintiff had filed proof of claim in the U.S. bankruptcy proceedings. Also *Roberts v. Picture Butte Municipal Hospital*, [1998] A.J. No. 817, 227 A.R. 308 (Alta. Q.B.); *Gyro-Trac (USA) Inc. (Arrangement relatif à)*, [2011] J.Q. no 14400, J.E. 2011-189 (Que. S.C.)9.

[7] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, s. s. 50.

[8] *Re Angiotech Pharmaceuticals Inc.*, [2011] B.C.J. No. 123, 76 C.B.R. (5th) 317 (B.C.S.C.) (citing a range of factors to be considered).

[9] *Massachusetts Elephant & Castle Group Inc., Re*, [2011] O.J. No. 3280, 81 C.B.R. (5th) 102 (Ont. S.C.J.).

2. Foreign Corporations

(1) Foreign Corporations

(a) Status, Powers, Domicile, Residence and Nationality HCF-269

(b) Changes in Status: Amalgamation, Dissolution, Winding-up HCF-270

(c) Carrying on Business: Registration and Limitations on Activities HCF-272

(2) Foreign Currency Obligations

(a) General Principle.. HCF-274

(b) Money of Account.. HCF-275

(c) Money of Payment HCF-278

(d) Exchange Control Legislation..................... HCF-280

(1) Foreign Corporations

(a) Status, Powers, Domicile, Residence and Nationality

▼HCF-269▼ Capacity to sue and be sued. Corporations duly created in foreign states or in other provinces or territories are recognized and permitted to sue and be sued[1] in Canada in their corporate capacity[2] subject, in certain cases,[3] to registering or obtaining a local licence.[4] However, a foreign corporation's failure to obtain a provincial licence does not immunize it against suits brought against it in any of the provinces or territories nor does it affect its corporate existence.[5]

Applicable law. Questions concerning the status of a foreign corporation, especially whether it possesses the attributes of legal personality, are, on the analogy of natural persons, governed by the law of the corporation's domicile. The domicile is in the place of incorporation or organization and it cannot be changed during the corporation's existence even if the corporation carries on business elsewhere.[6] Thus, the law of the state, province or territory under which a corporation has been incorporated or organized determines whether it has come into existence, its corporate powers and capacity to enter into any legal transaction,[7] the persons entitled to act on its behalf,[8] including the extent of their liability for the corporation's debts[9] and the rights of its shareholders.[10] The instrument of incorporation and the laws of a corporation's domicile govern not only its creation and continuing existence, but also matters of internal management, the creation of share capital and related matters, so that to determine questions affecting the status of a Canadian company and matters relating to its internal management reference must be had not only to the letters patent creating it and any supplementary letters patent and by-laws, but also to the powers and duties of the directors as set forth in the applicable legislation.[11] While the state, province or territory in which the foreign corporation intends to carry on business has the right to prescribe the extent to which the corporation may exercise its corporate powers and capacity, this does not mean that proceedings may be taken in this jurisdiction to affect its status as a corporation.[12] However, foreign partnerships formed solely for the purposes of creating a tax loss in the forum and not for doing business are governed by the law of the forum.[13]

Law governing liability for subsidiary. There is some controversy over which law determines the liability of a corporation for the obligations of a foreign subsidiary. Since the personality and status of the subsidiary are called into question, it would seem that the law applicable to the status and capacity of the subsidiary should determine whether its corporate veil can be pierced. Alternatively, the court might regard this as a question of the identity of the true defendant and, therefore, as a procedural question to which it would apply its own law. However, this approach could encourage forum shopping for the jurisdiction most favourable to piercing the corporate veil. For other matters, the law governing the contract or tort that gives rise to the litigation against the foreign subsidiary could determine whether the corporate veil may be pierced since, this is arguably a function of the dispute and not of the status of the corporation.

Québec. The domicile of a legal person is at the place and address of its head office, which is generally where it has been incorporated.[14] However, the status and capacity of a legal person are governed by the law of the country under which it was formed, but its activities may be governed by

TAB 108

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Although an English court[2] may consider that a transfer of foreign land has been effectively made, it may in practice be difficult for the trustee to enforce his title in the foreign jurisdiction. Even so, if the debtor is personally present within the jurisdiction, the court may be able to order him to act to support the trustee's obtaining an effective title to the land in a foreign jurisdiction[3]. Further, any court in the United Kingdom is obliged to assist another such court in insolvency matters upon request; and a request to a Scottish or Northern Irish court for assistance could enable an English trustee to obtain an effective title to property in Scotland or Northern Ireland[4]. A similar scheme exists under which the Secretary of State can designate other countries for the purposes of mutual assistance in insolvency matters[5].

A court may restrain a creditor from taking proceedings abroad to recover a debt due from a bankrupt debtor in order to preserve the principle of equal distribution among creditors. If the creditor has claimed in the English bankruptcy he may be so restrained[6]; if he is resident in England he may likewise be restrained[7]. It is unclear to what extent the courts retain a power to compel a creditor who has satisfied his claim against the debtor abroad to pool those assets for the benefit of creditors generally; but it is thought that the power has survived the Insolvency Act 1986[8]. Such a creditor will not be allowed to prove under the English bankruptcy unless he brings the assets into hotchpot[9]. If he chooses not to prove in the English bankruptcy he may still be ordered to pool the assets as if he were subject to the restraining jurisdiction of the English court[10].

[1] See the Insolvency Act 1986 ss 283 (as amended), 306, 436. In other words, the assignment of property to the trustee is universal, and the Act, to the extent that it operates to transfer foreign land to the trustee, claims to have a wider effect than would be acknowledged by an English court as the consequence of a foreign bankruptcy (see para 982 post). The property must be that of the debtor, and it will be assigned subject to such charges and burdens as are recognised by the lex situs: *Re Somes, ex p De Lemos* (1896) 3 Mans 131; *Galbraith v Grimshaw* [1910] AC 508, HL; *Re Sykes, Cloghran Stud Farm Co v The Trustee* (1932) 101 LJCh 298, DC; *Re Doyle, ex p Brien v Doyle* (1993) 112 ALR 653; cf *Murphy's Trustee v Aitken* 1983 SLT 78, Ct of Sess.

[2] As to the meaning of 'English' in relation to courts see para 604 ante.

[3] If the foreign court follows the same approach as the English conflict of laws, this will be the case: see Dicey and Morris *The Conflict of Laws* (12th Edn, 1993) 1164.

[4] See the Insolvency Act 1986 s 426 (as amended); and BANKRUPTCY AND INSOLVENCY vol 3(2) (Reissue) para 713.

[5] Ibid s 426(4), (11); and the Co-operation of Insolvency Courts (Designation of Relevant Countries and Territories) Order 1986, SI 1986/2123; and see para 994 post.

[6] *Re Tait & Co, ex p Tait* (1872) LR 13 Eq 311. Cf *Barclays Bank plc v Homan* [1993] BCLC 680.

[7] *Re Distin, ex p Ormiston* (1871) 24 LT 197.

[8] See *Re Paramount Airways Ltd (in administration)* [1993] Ch 223, [1992] 3 All ER 1, CA.

[9] *Re Morton, ex p Robertson* (1875) LR 20 Eq 733; *Banco de Portugal v Waddell* (1880) 5 App Cas 161, HL.

[10] See the cases in notes 6–7 supra.

980. Choice of law in an English bankruptcy. The court will administer the property of a bankrupt in accordance with English law as the lex fori[1]. A creditor may prove for any debt due to him from the bankrupt, no matter whether the debt is governed by English law or foreign law[2]. Of course, it may be necessary to refer to foreign law in order to discover whether a debt governed by a foreign proper law is valid by that law. But, subject to this, a foreigner proving for a foreign debt stands in the same position as an English creditor proving for an English debt[3]. The English court will apply its own rules designed to secure equality as between creditors of the same class, and will compel a creditor who seeks to prove in the English bankruptcy[4] or who is subject to the jurisdiction of the English court[5] to bring into the common pool any debt or dividend recovered by him abroad[6].

The Insolvency Act 1986 contains particular rules as to the effect of bankruptcy on antecedent transactions, such as the effect of a fraudulent preference, or of a transaction at an undervalue[7]. These permit a court to reopen and reverse a transaction entered into by the bankrupt with another person[8]. Although there is no territorial restriction upon who the other person may be, and no express restriction upon the nature or locus of the transaction, if a claim is made under these provisions, it must be shown that there is sufficient connection between the defendant (against whom an order is sought) and England to make it just and convenient in all the circumstances to make the order despite the foreign element[9]. If the defendant is outside the jurisdiction, the service on him of the proceedings will require the leave of the court; and the grant of leave will depend on, inter alia, the strength or otherwise of the connection of the defendant with England[10].

[1] *Re Melbourn, ex p Melbourn* (1870) 6 Ch App 64; *Thurburn v Steward* (1871) LR 3 PC 478; *Re Scheibler, ex p Holthausen* (1874) 9 Ch App 722; *Re Kloebe, Kannreuther v Geiselbrecht* (1884) 28 ChD 175; *Re Doetsch, Matheson v Ludwig* [1896] 2 Ch 836.

[2] *Re Melbourn, ex p Melbourn* (1870) 6 Ch App 64; *Re Kloebe, Kannreuther v Geiselbrecht* (1884) 28 ChD 175.

[3] *Re Scheibler, ex p Holthausen* (1874) 9 Ch App 722; *Re Wiskemann, ex p Trustee* (1923) 92 LJCh 349.

[4] *Selkrig v Davies* (1814) 2 Dow 230 at 249, HL; *Re Morton, ex p Robertson* (1875) LR 20 Eq 733; *Banco de Portugal v Waddell* (1880) 5 App Cas 161, HL.

[5] *Sill v Worswick* (1791) 1 Hy Bl 665; *Hunter v Potts* (1791) 4 Term Rep 182; *Phillips v Hunter* (1795) 2 Hy Bl 402.

[6] Ie except in pursuance of a judgment in rem given by a foreign court: *Minna Craig SS Co v Chartered Mercantile Bank of India, London and China* [1897] 1 QB 460, CA.

[7] See the Insolvency Act 1986 ss 339–342 (as amended), 423–425; and generally BANKRUPTCY AND INSOLVENCY vol 3(2) (Reissue) para 644 et seq.

[8] See ibid ss 339, 340, 423.

[9] *Re Paramount Airways Ltd (in administration)* [1993] Ch 223, [1992] 3 All ER 1, CA.

[10] Insolvency Rules 1986 r 12.12 (see para 978 text and note 16 ante); *Re Paramount Airways Ltd (in administration)* [1993] Ch 223, [1992] 3 All ER 1, CA; *Re Busytoday Ltd, Popely v Lewis* [1992] 4 All ER 61, [1992] 1 WLR 683; *Re Tucker (a bankrupt) (No 2), ex p the Trustee v Langton Investment SA* [1988] 2 All ER 339, [1988] 1 WLR 497.

981. Discharge by reason of an English order. An order of discharge under an English bankruptcy discharges the debtor from all debts provable in the bankruptcy, irrespective of the law which governs the contract giving rise to the debt[1], because it operates as a release from all debts provable in bankruptcy[2]. In addition, a discharge in accordance with the law which governs the contract or debt is a valid discharge in England[3], and the same principle may apply to a voluntary arrangement[4] under the Insolvency Act 1986[5].

[1] *Royal Bank of Scotland v Cuthbert* (1813) 1 Rose 462; *Gill v Barron* (1868) LR 2 PC 157; *Ellis v M'Henry* (1871) LR 6 CP 228.

[2] Insolvency Act 1986 s 281(1); and BANKRUPTCY AND INSOLVENCY vol 3(2) (Reissue) para 630.

[3] See paras 854 ante, 982 post.

[4] See para 978 note 8 ante.

[5] See the Insolvency Act 1986 ss 260, 261; and Dicey and Morris *The Conflict of Laws* (12th Edn, 1993) 1172.

982. Effect in England of foreign bankruptcies. An English court may not question the jurisdiction of a Scottish or Northern Irish court to adjudicate a debtor bankrupt[1]. They will recognise that the courts of a foreign country have jurisdiction over a debtor if he was domiciled in that country at the time of presentation of the petition[2], or if he submitted to the jurisdiction of the court by presenting the petition

TAB 109

HMANALY I§12
Houlden & Morawetz Analysis I§12

Houlden and Morawetz Bankruptcy and Insolvency Analysis

Bankruptcy and Insolvency Act
Part VII (ss. 183-197)

L.W. Houlden and Geoffrey B. Morawetz

I§12 — Rules of Evidence

I§12 — Rules of Evidence

See ss. 183, 184, 185, 186

In all bankruptcy matters, provincial laws of evidence may be invoked and followed insofar as they are not inconsistent with or contrary to the rules of evidence contained in the Canada *Evidence Act* and the *Bankruptcy and Insolvency Act* and Rules. Since the *Canada Evidence Act* provides that the taking of evidence in Canadian courts applies to all civil proceedings and other matters respecting that over which the Parliament of Canada has jurisdiction, resort should be first had to that statute in all matters pertaining to witnesses and evidence, where the *Bankruptcy and Insolvency Act* and Rules make no specific provision for a particular situation: *Grande Textiles Ltd. v. Drunker* (1954), 34 C.B.R. 213 (Que. S.C.); *Re Mercier* (1963), 5 C.B.R. (N.S.) 153 (Que. S.C.).

A judgment in a prior civil or criminal case is admissible as evidence in subsequent interlocutory proceedings as proof of its findings and conclusions, provided the parties are the same or were themselves participants in the prior proceedings on the same or similar issues. It will be for the judge to assess the weight. The prejudiced party will have an opportunity to lead evidence to contradict it or lessen its weight, unless precluded from doing so by the doctrines of *res judicata*, issue estoppel or abuse of process: *British Columbia (Attorney General) v. Malik* (2011), 2011 CarswellBC 923, 2011 CarswellBC 924, 76 C.B.R. (5th) 56 (S.C.C.).

The Ontario Superior Court of Justice reviewed the law relating to admissibility of expert opinion evidence and rejected the plaintiff's objection to the defendants' expert witness. When expert evidence is challenged on the basis that it is biased or partial, it is important to identify the nature of the alleged bias or partiality. Legal advocacy, containing legal analyses and argument, legal interpretations and conclusions, which masquerades as expert evidence is distinctly different from expert evidence that is alleged to be biased or partial on the basis of the expert witness having a connection to a party or an issue in the case. Where there is an allegation that a witness is biased or partial because the witness has a connection with a party or a matter in issue, the courts have treated the issue as one that goes to weight rather than admissibility. When a challenge to expert evidence is based on the expert witness having a connection to a party or an issue in the case or a possible predetermined position on the case, the essence of the challenge is that the evidence is not reliable because the expert has tailored his or her evidence to suit the position of the particular party or the expert's personal views. It is an ultimate reliability issue, the determination of which calls for an overall assessment of the evidence, carried out in the usual way that a court assesses evidence, and involving a review of consistencies and inconsistencies, determinations of credibility and judging whether the evidence helps to establish points in issue and makes sense. The assessment of ultimate reliability cannot take place at the admissibility stage: *Henderson v. Risi* (2012), 2012 CarswellOnt 8097, 2012 ONSC 3459 (Ont. S.C.J.).

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HMANALY N§1
Houlden & Morawetz Analysis N§1

Houlden and Morawetz Bankruptcy and Insolvency Analysis

Companies Creditors Arrangement Act
Section 1

L.W. Houlden and Geoffrey B. Morawetz

N§1 — Introduction to the Companies' Creditors Arrangement Act

N§1 — Introduction to the *Companies' Creditors Arrangement Act*

See s. 1

The *Companies' Creditors Arrangement Act* is a facilitative statute, aimed at allowing financially distressed businesses to devise a plan of compromise or arrangement with their creditors, with a view to becoming viable in the future. The original *Act*, S.C. 1932-33, c. 36, came into force May 23, 1933 (see 16 C.B.R. 447 for the original *Act*). The *CCAA* is derived from s. 153 of the *English Companies Act*, 1929 (19 and 20 Geo. V, c. 23). Although the *CCAA* has been amended on other occasions, the principal amendments were made in 1953 by S.C. 1952-53, c. 3. The 1953 amendments enlarged the definition of "unsecured creditor". The present statute is called the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36. For convenience, the statute will be referred to as the *CCAA*. The *Act* permits compromises or arrangements to be made between an insolvent company and its unsecured creditors or any class of them and between secured creditors and any class of them.

Extensive amendments to the *CCAA* were undertaken in *An Act to Establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, Chapter 47, Royal Assent November 25, 2005, the *CCAA* provisions not yet proclaimed in force as of September 18, 2009 (Chapter 47). Further amendments were introduced under Bill C-52 *An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2007*, Royal Assent June 22, 2007, Chapter 29 Statutes of Canada 2007; and *An Act to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005.*

A *CCAA* proceeding is different from an ordinary civil action and trial, and the dynamic process is such that "real time" process should only be stifled when to do otherwise would operate as a significant prejudice to a creditor or group of creditors: *Re 1587930 Ontario Ltd.* (2006), 2006 CarswellOnt 6419, 25 C.B.R. (5th) 260 (Ont. S.C.J. [Commercial List]).

In *Reference Re Companies' Creditors Arrangement Act (Canada)* (1934), 16 C.B.R. 1, [1934] S.C.R. 659, [1934] 4 D.L.R. 75, the Supreme Court of Canada held that the *Act* was *intra vires* Parliament, coming within the domain of bankruptcy and insolvency, vested in Parliament by s. 91(21) of the *Constitution Act, 1867.*

The *CCAA* and the *Bankruptcy and Insolvency Act* are two distinct statutes, and one is not auxiliary to the other: *Parisian Cleaners & Laundry Ltd. v. Blondin* (1938), 20 C.B.R. 452, 66 Que. K.B. 456 (Que. C.A.); *Québec (Sous-ministre du Revenu) v. Wynden Canada Inc.* (1982), 47 C.B.R. (N.S.) 76, [1983] C.S. 194 (Que. S.C.). The *CCAA* does, however, adopt some of the definitions of the *BIA*.

The reorganization of a company's affairs under the *CCAA* may take many forms, and solutions are limited only by the creativity of those structuring the plan of arrangement: *Re Blue Range Resource Corp.* (1999), 1999 CarswellAlta 597, [1999] A.J. No. 788, 245 A.R. 154, 1999 ABQB 1038 (Alta. Q.B.); leave to appeal allowed (1999), [1999] A.J. No. 975, 1999 CarswellAlta 809, 244 A.R. 103, 209 W.A.C. 103, 12 C.B.R. (4th) 186, 1999 ABCA 255 (Alta. C.A.); reversed

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(2000), 2000 CarswellAlta 731, [2000] A.J. No. 830, 2000 ABCA 200, 261 A.R. 162, 225 W.A.C. 162, [2000] 11 W.W.R. 117, 84 Alta. L.R. (3d) 65 (Alta. C.A.); and *Re 843504 Alberta Ltd.* (2003), 2003 CarswellAlta 1786, 2003 ABQB 1015, 4 C.B.R. (5th) 306, 30 Alta. L.R. (4th) 91, 351 A.R. 222 (Alta. Q.B.).

If a conflict arises between the *CCAA* and either federal or provincial statutes, the *CCAA* prevails: *Pacific National Lease Holding Corp. v. Sun Life Trust Co.* (1995), 34 C.B.R. (3d) 4 (B.C. C.A.); *Re Smoky River Coal Ltd.* (1999), 175 D.L.R. (4th) 703, 237 A.R. 326, 12 C.B.R. (4th) 94, 1999 CarswellAlta 491, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 74, 197 W.A.C. 326 (C.A.); *Montreal Trust Co. v. Abitibi Power & Paper Co.* (1938), 20 C.B.R. 32, [1938] O.R. 589, [1938] 1 D.L.R. 548 (C.A.). In *PCT Building Ltd. v. Canadian Airlines Corp.* (2001), 34 C.B.R. (4th) 266, 2001 CarswellAlta 1800, 296 A.R. 128 (Alta. Q.B.), this statement of the law was held to apply to statutory tax provisions.

Provincial legislation that confers a right on shareholders to enjoin a proposed sale of the whole or substantially the whole of the undertaking of a company unless it has been approved by a special resolution of shareholders is unenforceable if it conflicts with a plan under the *CCAA*: *Re Loewen Group Inc.* (2001), 32 C.B.R. (4th) 54, 2001 CarswellOnt 4910, 22 B.L.R. (3d) 134 (Ont. S.C.J. [Commercial List]).

The doctrine of paramountcy will apply either where a provincial and a federal statutory provision are in conflict and cannot both be complied with, or where complying with the provincial law will have the effect of frustrating the purpose of the federal law and therefore the intent of Parliament. Parliament's intent for the operation of the *CCAA* regime should not be thwarted by the operation of provincial legislation: *Re Nortel Networks Corp.* (2009), 2009 CarswellOnt 7383, [2009] O.J. No. 4967, 2009 ONCA 833 (Ont. C.A.). For a discussion of this judgment, see N§65 "Scope of Order under Initial Application".

While historically, the statute was not used as a means of winding-up a company *Re D. W. McIntosh Ltd.*, *supra*; *Re Avery Const. Co.*, *supra*; and *Re Arthur Flint Co.*, *supra*, in recent years there have been a number of cases where it is in the best interests of creditors to avoid bankruptcy or winding-up proceedings and to conduct an orderly liquidation under a plan of compromise or arrangement under the *CCAA*: *Re Quintette Coal Ltd.* (1991), 10 C.B.R. (3d) 197, 1991 CarswellBC 444, 62 B.C.L.R. (2d) 218 (S.C.). The court in *Re Assoc. Investors of Can. Ltd.* held that the *CCAA* may be invoked as a means of liquidating a company if the benefits that would flow to creditors from utilizing the *Act* would not be available if liquidation occurred under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*; there is judicial control over the liquidation process and an effective means of investigating the affairs of the company; the company may be investigated and the results of the investigation made available to the court; the plan must be fair and reasonable and there must be an absence of any findings of illegality: *Re Associated Investors of Canana Ltd.* (1987), 67 C.B.R. (N.S.) 237, 56 Alta. L.R. (2d) 259, 46 D.L.R. (4th) 669 (Alta. Q.B.). With respect, these conditions may be too rigorous. If the court finds that the plan is fair and reasonable and in the best interests of creditors, there seems no reason why an orderly liquidation could not be carried out under the *CCAA*. See *Re Amirault Fish Co.* (1951), 1951 CarswellNS 6, 32 C.B.R. 186 (N.S. S.C.) where a company that was being wound up under provincial legislation proved to be insolvent so that it was not possible to use provincial legislation to make a distribution to creditors, and the court held that is was appropriate to use the *CCAA* to carry out the distribution. To the same effect, see *Re Olympia & York Developments Ltd.* (1995), 34 C.B.R. (3d) 93, 1995 CarswellOnt 340 (Ont. Gen. Div. [Commercial List]); *Re Anvil Range Mining Corp.* (2001), 25 C.B.R. (4th) 1, 2001 CarswellOnt 1325 (Ont. S.C.J. [Commercial List]); affirmed (2002), 34 C.B.R. (4th) 157, 2002 CarswellOnt 2254 (Ont. C.A.). However, in Alberta, the preference may be to expect the corporate entity to continue in some form or another and liquidations proposals are allowed only in exceptional circumstances: *Re 843504 Alberta Ltd.* (2003), 2003 CarswellAlta 1786, 2003 ABQB 1015, 4 C.B.R. (5th) 306, 30 Alta. L.R. (4th) 91, 351 A.R. 222 (Alta. Q.B.).

See Shelley Fitzpatrick, "Liquidating *CCAA*s — Are We Praying to False Gods?"; and Bill Kaplan, "Liquidating *CCAA*s: Discretion Gone Awry?", in J. Sarra, ed., *Annual Review of Insolvency Law, 2008* (Toronto: Carswell, 2009).

Unlike a proposal under the *Bankruptcy and Insolvency Act*, if a plan under the *CCAA* is not accepted by creditors, the company is not automatically bankrupt.

If proceedings are taken by a creditor for appointment of a receiver and proceedings are taken by the debtor company under the *CCAA*, the *CCAA* is the dominant legislation, since it is directed to the overall purpose of providing for arrangements and compromises of the claims of creditors that meet the requirements of the *Act*. Where appropriate, the court will stay the receivership proceedings to permit the debtor to present a plan of reorganization under the *CCAA*: *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 138, 1988 CarswellBC 552 (B.C. S.C. [In Chambers]).

Since the *Act* is a Federal *Act*, an order made under the *Act* in one province will be binding in other provinces: *Lehndorff United Properties (Canada) Ltd. v. Confederation Life Insurance Co.* (1993), 17 C.B.R. (3d) 198, 82 Man. R. (2d) 286, 1993 CarswellMan 25 (Q.B.).

The rights of creditors under the *CCAA* cannot be compromised unless

1. the creditor has been given a right to vote in the appropriate class on the proposed plan;

2. the creditor's vote is in accordance with a value ascribed to the claim by a court approved procedure;

3. the class in which the creditor has been appropriately placed has voted by a majority in number and two-thirds in value in favour of the plan; and

4. the court has sanctioned the plan on the basis that it is fair and reasonable (with considerable deference being given by the court in this regard to the votes of the creditors): *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500, 17 C.B.R. (3d) 1, 1993 CarswellOnt 182 (Gen. Div.); *Menegon v. Philip Services Corp.* (1999), 11 C.B.R. (4th) 262, 1999 CarswellOnt 3240 (Ont. S.C.J. [Commercial List]).

The Ontario Court of Appeal held that the fact that a plan of arrangement under the *CCAA* is put forth by a secured creditor, the plan vests all of the debtor company's assets into a non-arm's length purchaser, and operates exclusively for the benefit of secured creditors, does not, in and of itself, negate the fairness and reasonableness of such a plan where it can be shown that, even outside of the plan, the assets of the debtor company will not generate any recovery for unsecured creditors: *Re 1078385 Ontario Ltd.* (2004), 2004 CarswellOnt 8034, 16 C.B.R. (5th) 152 (Ont. C.A.).

The Ontario Superior Court of Justice noted that if any stakeholder does not voluntarily participate in the mediation between all stakeholders of an insolvent corporation in a *CCAA* proceeding, the monitor, at the mediator's request, may move for an order that such participation be directed and ordered by the court: *Re Stelco Inc.* (2005), 2005 CarswellOnt 2010, 11 C.B.R. (5th) 163 (Ont. S.C.J. [Commercial List]).

The British Columbia Court of Appeal held that while *CCAA* proceedings may require those with a financial stake in the company to compromise some of their rights in order to sustain the business, it cannot be said that the priorities between those with a financial stake are meaningless as priorities are always in the background and influence the decisions of those who vote on the plan: *Caterpillar Financial Services Ltd. v. 360networks Corp.* (2007), 2007 CarswellBC 29, 2007 BCCA 14, 61 B.C.L.R. (4th) 334, 28 E.T.R. (3d) 186, 27 C.B.R. (5th) 115, 10 P.P.S.A.C. (3d) 311 (B.C. C.A.).

The Ontario Divisional Court held that it is appropriate to appoint a receiver at the request of a secured creditor in the context of a debtor's *CCAA* proceedings and to permit the secured creditor to enforce on its security where there is evidence before the court that the assets and property subject to the secured creditor's security are in jeopardy of material deterioration: *I.F. Propco Holdings (Ontario) 36 Ltd. v. 1228851 Ontario Ltd.* (2002), 2002 CarswellOnt 6613, [2002] O.J. No. 1667 (Ont. Div. Ct.).

The Supreme Court of Canada has held the history of the *CCAA* distinguishes it from the *BIA* because although these statutes share the same remedial purpose of avoiding the social and economic costs of liquidating a debtor's assets, the *CCAA* offers more flexibility and greater judicial discretion than the rules-based mechanism under the *BIA*, making the former more responsive to complex reorganizations. The Supreme Court of Canada held that Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected, notably creditors and employees; and that a workout that allowed the company to survive was optimal. It held that courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed. The Court held that reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs: *Re Ted Leroy Trucking Ltd.* (2010), 2010 CarswellBC 3419, 2010 CarswellBC 3420, 2010 SCC 60, 72 C.B.R. (5th) 170 (S.C.C.). For a full discussion of this case, see N§101 "Claims under the *Excise Tax Act*".

There have been a number of articles and books written about the *CCAA*. See, for example, S. Edwards, "Reorganization under the *Companies Creditors Arrangement Act*" (1947), 25 Can. Bar Rev. 587; Robert Thornton *et al*, "Air Canada and Stelco: Legal Developments and Practical Lessons", in J. Sarra, ed., *2006 Annual Review of Insolvency Law* (Toronto: Carswell, 2007) at 73-114; Derrick C. Tay, "Inherent Jurisdiction: The Silver Bullet of James M. Farley", *ibid*, at 1-18; Fred Myers, "Justice Farley in Real Time", *ibid.* at 19-32; William E. Aziz, Richard M. Grudzinski and Edward A. Sellers, "Practical Aspects of Governing Distressed Enterprises in Canada", *ibid.* at 365-420; L. J. Crozier, "Good Faith and the *Companies' Creditors Arrangement Act*" 15 Can. Bus. L.J. 89; D. Baird, D. Goldman, and M. Wrinczok, "Arrangements under the *Companies' Creditors Arrangement Act*" 1 C.B.R. (3d) 135; Mark E. Meland, "Extending 'Protection' to Third Parties in a Restructuring Plan", 20 C.B.R. (3d) 61; Elizabeth Murphy, Janis Sarra and Michael Creber, "Credit Derivatives in Canadian Insolvency Proceedings, 'The Devil will be in the Details'", in J. Sarra, ed., *2006 Annual Review of Insolvency Law* (Toronto: Carswell, 2007) at 187-234; Keith Pritchard, "Analysis of Recent Cases under the *Companies' Creditors Arrangement Act*" (2004) 40 Canadian Business L. J. 116; Rupert Chartrand, Edward Sellers and Natasha MacParland, "AT&T Canada: A New Brand of Telecom Restructuring", *Annual Review of Insolvency Law, 2003* (Toronto: Carswell, 2004) at 211; Ronald B. Davis, "Restructuring Proceedings and Pension Fund Deficits: A Question of Risk and Reward, *Annual Review of Insolvency Law, 2003* (Toronto: Carswell, 2004); Janis P. Sarra, *Rescue! The Companies Creditors Arrangement Act* (Carswell, Toronto, 2007); Derrick C. Tay and Charles Pasparakis, "Shareholder Approval Not Needed for Transfer of All the Company's Assets When Done Under the *CCAA*" 32 C.B.R. (4th) 64; Stephanie Ben-Ishai and Virginia Torrie, "A 'Cost'-Benefit Analysis: Examining Professional Fees in *CCAA* Proceedings" and David P. Bowra and Heather Ferris, "Real Estate Development Insolvencies, a British Columbia Perspective", in Janis Sarra, ed., *Annual Review of Insolvency Law, 2009* (Toronto: Carswell, 2010) at 144-167 and 315-342; Derrick C. Tay and Jennifer L. Stam, "The Challenges of Restructuring an Integrated International Business: The Nortel Experience", in Janis Sarra, ed., *Annual Review of Insolvency Law, 2009* (Toronto: Carswell, 2010) at 233-242; Robert J. Chadwick and Derek R. Bulas, "*Ad Hoc* Creditors' Committees in *CCAA* Proceedings: The Result of a Changing and Expanding Restructuring World", in J. Sarra, ed., *Annual Review of Insolvency Law, 2011* (Toronto: Carswell, 2012) 119-133; William C. Kaplan, "Stays Of Proceedings under The *Canada Business Corporations Act*: A Question Of Balance", in J. Sarra, ed., *Annual Review of Insolvency Law, 2011* (Toronto: Carswell, 2012) 135-164; Jay Carfagnini and Caterina Costa, "Claims for Post-Filing Interest and Prepayment Premiums in a CCAA Proceeding", in J. Sarra, ed., *Annual Review of Insolvency Law, 2011* (Toronto: Carswell, 2012) 165-190; Brendan O'Neill, "New Battlegrounds - Update on Intercreditor Tranche Warfare in the Fields of Credit Bidding and Intercreditor Agreements", in J. Sarra, ed., *Annual Review of Insolvency Law, 2011* (Toronto: Carswell, 2012).

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TAB 110

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Corporate, Insolvency and Competition Law Policy

Statutory Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

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Corporate, Insolvency and Competition Law Policy

Statutory Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

Discussion Paper

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Executive Summary

Pursuant to a statutorily-mandated review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*, Industry Canada is conducting public consultations to obtain submissions from interested Canadians regarding Canada's insolvency legislation. The discussion paper, which sets out numerous issues identified from key stakeholder input and an environmental scan of the insolvency marketplace, is intended to provide a framework for the public consultations.

The discussion paper is divided into four sections: first, an introduction; second, consumer insolvency issues; third, commercial insolvency issues; and, finally, administrative and technical issues.

The introduction provides general information regarding Canada's insolvency regime and the policy objectives that underlie it, as well as recent marketplace changes and insolvency trends.

The sections on consumer and commercial issues set out broad themes under which specific issues may be found. For example, the consumer insolvency themes include protection of consumer interests, the "fresh start" principle, consumer exemptions, protecting families, and treatment of student loans in bankruptcy. The commercial insolvency themes include encouraging restructuring, protecting vulnerable creditors and enhancing equity, deterring fraud and abuse, and cross-border insolvencies.

The section on administrative and technical issues sets out a number of discrete matters, including renaming the *Bankruptcy and Insolvency Act*, creating a unified insolvency Act, and marshalling of charges.

Pursuant to the statutory review provisions contained in both Acts, the Minister of Industry is to table a report in Parliament on the "provisions and operations" of the Act by September 2014. The report would then be referred to a Parliamentary committee for study and report within 12 months of the initial tabling. Any decisions regarding possible legislative or regulatory reforms as part of the statutory review would be taken following consideration of the Parliamentary committee's study and report.

Introduction

The Importance of Insolvency Law

Insolvency laws have a significant impact on the economy. Insolvency rules offer security for investors and lenders in both consumer and commercial borrowing transactions. This, in turn, influences credit market risks, which can affect the cost and availability of credit. In the commercial sphere, the reliability of the insolvency system plays a role in attracting domestic and foreign investment, as well as in promoting entrepreneurship and innovation.

One of the principal considerations in an era of increased globalization and competitiveness is how to make the insolvency process as efficient as possible, while maintaining fairness. By facilitating corporate restructuring and directing assets to productive use, the insolvency system contributes to Canada's economic competitiveness and performance.

Rules governing personal insolvency play an important socio-economic role. They allow honest but unfortunate individuals who experience difficult financial distress to release their debts and obtain a fresh start. The consumer insolvency provisions are aimed at balancing the interests of debtors with the interest of creditors who extended credit in the expectation of repayment.

As such, insolvency laws contribute in a meaningful way to the effective and efficient functioning of the marketplace.

Canada's Insolvency Regime

Legislative Framework

The insolvency regime makes up part of Canada's fundamental marketplace framework laws and relies on two main statutes: the *Bankruptcy and Insolvency Act* (BIA) and the *Companies' Creditors Arrangement Act* (CCAA).

The BIA provides a legislative framework to address both consumer and commercial insolvency situations. In bankruptcy, the Act provides for the liquidation of the bankrupt's assets by a trustee and the distribution of the proceeds in a fair and orderly way among the creditors. Alternatively, the Act provides a mechanism for insolvent consumers or commercial debtors to avoid bankruptcy by negotiating settlements with their creditors to reorganize the debtor's financial affairs.

The CCAA provides a legislative framework for the reorganization of insolvent commercial debtors under the court's supervision. It enables an insolvent business to seek a court order staying its creditors from taking action against it while it negotiates an arrangement with them for the rescheduling or compromise of its debts. The CCAA provides a more flexible, court-driven process than the BIA. Businesses reorganizing under the Act must have more than $5 million in debt.

Administrative Framework

Canada's insolvency regime's administrative framework is supported by three pillars:

- **Office of the Superintendent of Bankruptcy** (OSB): regulator with oversight responsibilities for the insolvency system;
- **Trustees-in-Bankruptcy**: licensed by the Superintendent, they are responsible for administering estates and performing various roles under the BIA and CCAA; and
- **Courts** (including registrars in bankruptcy): supervise CCAA proceedings and adjudicate matters under both the BIA and CCAA.

The OSB has statutory responsibility to supervise the administration of all estates and matters under the BIA. Additionally, the OSB has certain functions under the CCAA, including maintaining a public record of CCAA proceedings and investigating complaints regarding the conduct of monitors. In fulfilling its mandate, the OSB sets standards and provides guidance to stakeholders regarding expected conduct through Directives, notices, position papers and programs.

Trustees-in-bankruptcy are responsible for administering insolvencies and can often be engaged to provide advice to financially distressed individuals and businesses. They work with the debtor to complete necessary steps in a bankruptcy, proposal to creditors or restructuring. This involves filing documents with the OSB and ensuring the debtor fulfills the requirements under the BIA or CCAA. Where the debtor fails to fulfill the requirements, as an officer of the court, the trustee is to bring the issues to the attention of the creditors and the court.

The role of the courts varies depending upon the nature of the proceeding. Most individuals who file for bankruptcy will not be required to go to court. Instead, they will obtain a discharge from bankruptcy after the specified period of time through an automatic process. If a trustee or creditor opts to oppose a bankrupt's discharge, the matter is brought to the courts. In other proceedings, the courts are involved at various stages. For example, the courts may be required to resolve disputes or sanction specific actions proposed by the debtor or creditors. In CCAA proceedings, the court plays a key role. Court approval is required to commence a proceeding and it may make various other orders, including approving interim financing, the process for sale of assets, and the disclaimer of contracts. Courts are also responsible for sanctioning any plan of arrangement or compromise.

Objectives of Insolvency Law

Insolvency laws aim to minimize the impact of a debtor's insolvency on all stakeholders. They do this by pursuing the key objectives of equitable distribution of the debtor's assets, and, where possible, by rehabilitation of the debtor.[1] As noted by the Supreme Court of Canada:

> The very design of insolvency legislation raises difficult policy issues for Parliament. Legislation that establishes an orderly liquidation process for situations in which reorganization is not possible, that averts races to execution and that gives debtors a chance for a new start is generally viewed as a wise policy choice. Such legislation has become part of the legal and economic landscape in modern societies. But it entails a price, and those who might have to pay that price sometimes strive mightily to avoid it. Despite the proven wisdom of the policies underpinning the insolvency legislation, it is understandable that few appreciate the "haircuts" or even outright losses that bankruptcies trigger.[2]

It is generally accepted that the objectives of insolvency law may be achieved through legislation that does the following:

- provides certainty in the market to promote economic stability and growth;
- maximizes value of assets;
- strikes a balance between liquidation and reorganization;
- ensures equitable treatment of similarly situated creditors;
- provides for timely, efficient and impartial resolution of insolvency;
- preserves the insolvency estate to allow equitable distribution to creditors;
- ensures a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and
- recognizes existing creditor rights and establishes clear rules for ranking of priority claims.[3]

It is in this context that Canada's insolvency laws have been developed by Parliament and have evolved through court decisions.

Marketplace Changes

Since the last public consultations on insolvency laws conducted in 2001-2002, which resulted in the legislative reforms of 2008 and 2009, the characteristics of the Canadian consumer marketplace have changed. The ratio of consumer debt to personal disposable income in Canadian households has increased from approximately 110 percent in 2000 to 160 percent in 2012.[4] The increase can be attributed to higher mortgage debt levels and an increase in home equity extraction, both associated with elevated housing prices.[5] Higher mortgage debt levels are a potential source of risk as Canadians may be more vulnerable to a decline in housing prices or an increase in interest rates.

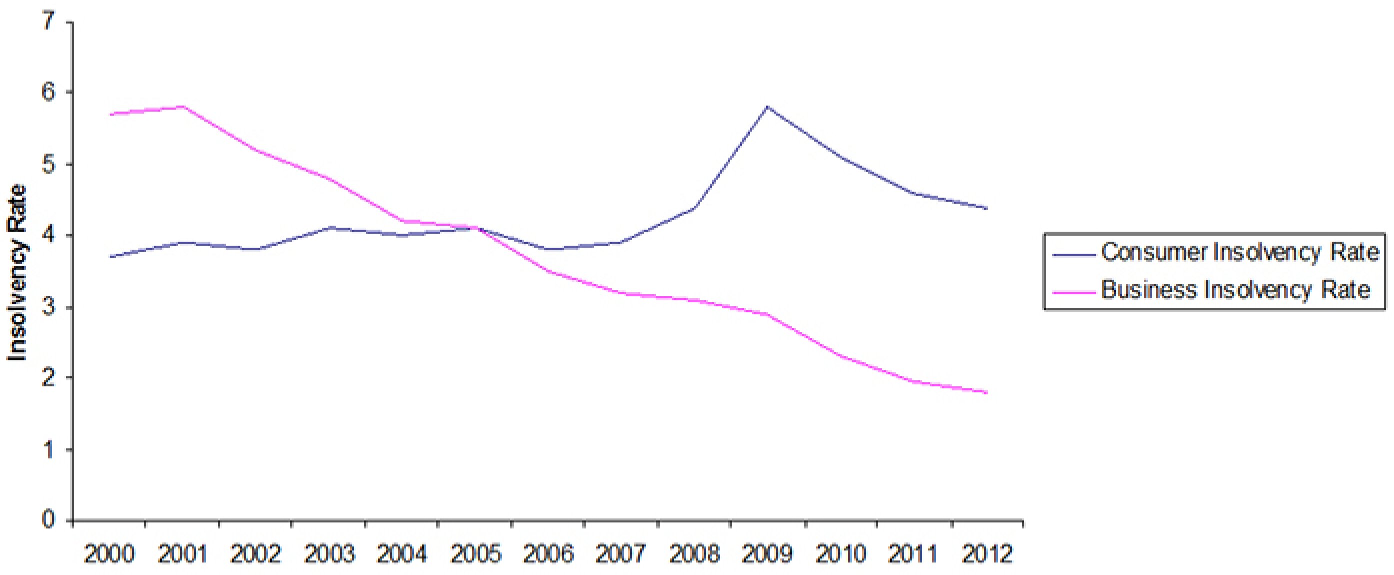
In the commercial context, marketplace changes include the growing importance of intellectual property to Canadian companies, the use of more complex corporate structures, a shift by lenders away from relationship lending, significant growth in the use of derivatives to hedge risk and in the practice of distressed debt trading, and an increasing number of cross-border insolvency proceedings. At the same time, the cost and complexity of restructuring proceedings, particularly under the CCAA, continues to grow, resulting in a shift towards other types of workout arrangements such as private workouts and arrangements under the *Canada Business Corporations Act*.

Insolvency Trends

National Insolvency Rates

Figure 1 illustrates the national consumer and business insolvency rates between 2000 and 2012.[6] An overview of insolvency rates provides a clearer picture of trends than does the total volume alone, because it takes into account changes in population sizes over time. As shown in Figure 1, consumer and business insolvency rates have trended in opposite directions during the past decade. The consumer insolvency rate remained relatively steady from 2002 to 2007 before increasing to 5.8 during the economic downturn in 2009 and declining in subsequent years. In 2000 and 2012, the national consumer insolvency rates were 3.7 and 4.4, respectively. This represents an 18 percent increase in the insolvency rate over this period. On the other hand, other than a small increase during the 2001 economic downturn, business insolvency rates have trended downward throughout the decade. In 2000 and 2012, the national business insolvency rates were 5.7 and 1.8 respectively, representing a 68.4 percent decrease.

Figure 1: Consumer and Business Insolvency Rates



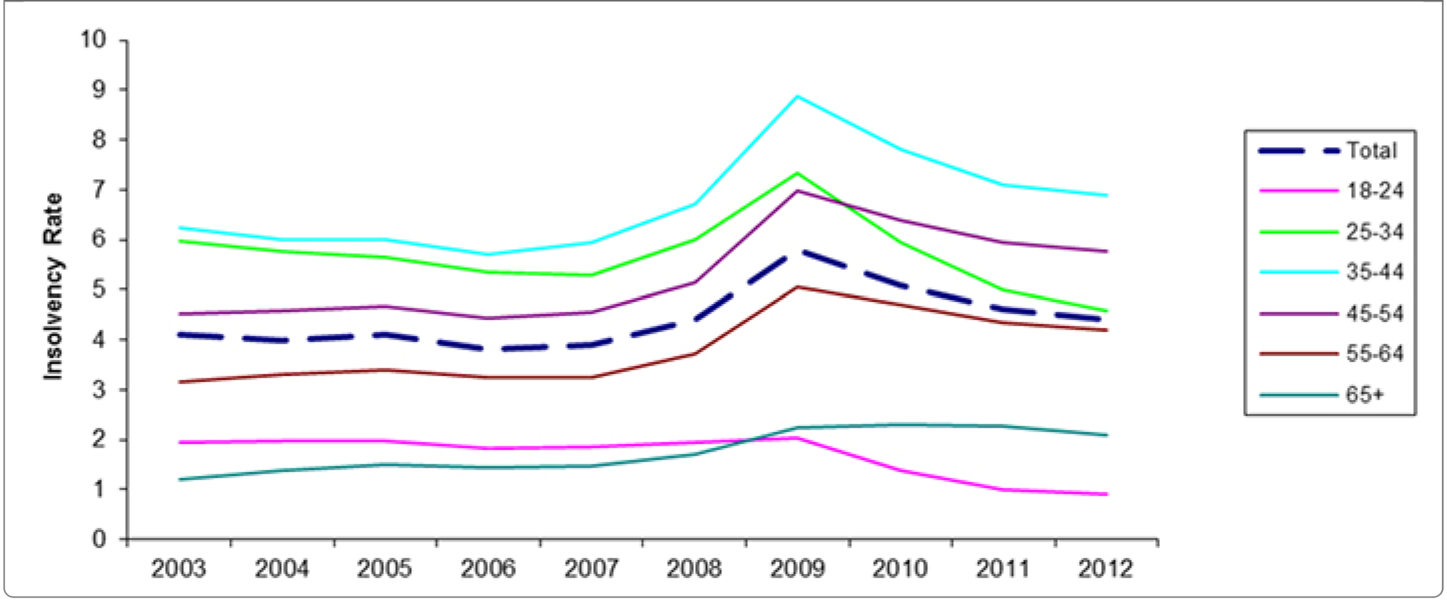
Consumer Insolvency Rate - by Age and Regional Breakdowns

Insolvency does not affect all segments of society equally. Variations in the rates of insolvency by age cohort and by geographic region provide important information regarding insolvency trends in Canada.

Figure 2 shows the national consumer insolvency rate by age cohort. During the past decade, younger Canadians (those between 18 and 34) became significantly less likely to commence insolvency proceedings. On the other hand, Canadians aged 35 and older become more likely to enter insolvency proceedings. This demographic trend is consistent with anecdotal reports that delayed transitions to adulthood among younger Canadians may be placing a greater financial burden on the parents of adult offspring.[7]

It is also important to note that while the insolvency rate of individuals over the age of 65 has increased over the past decade, it still remains well below the national average.

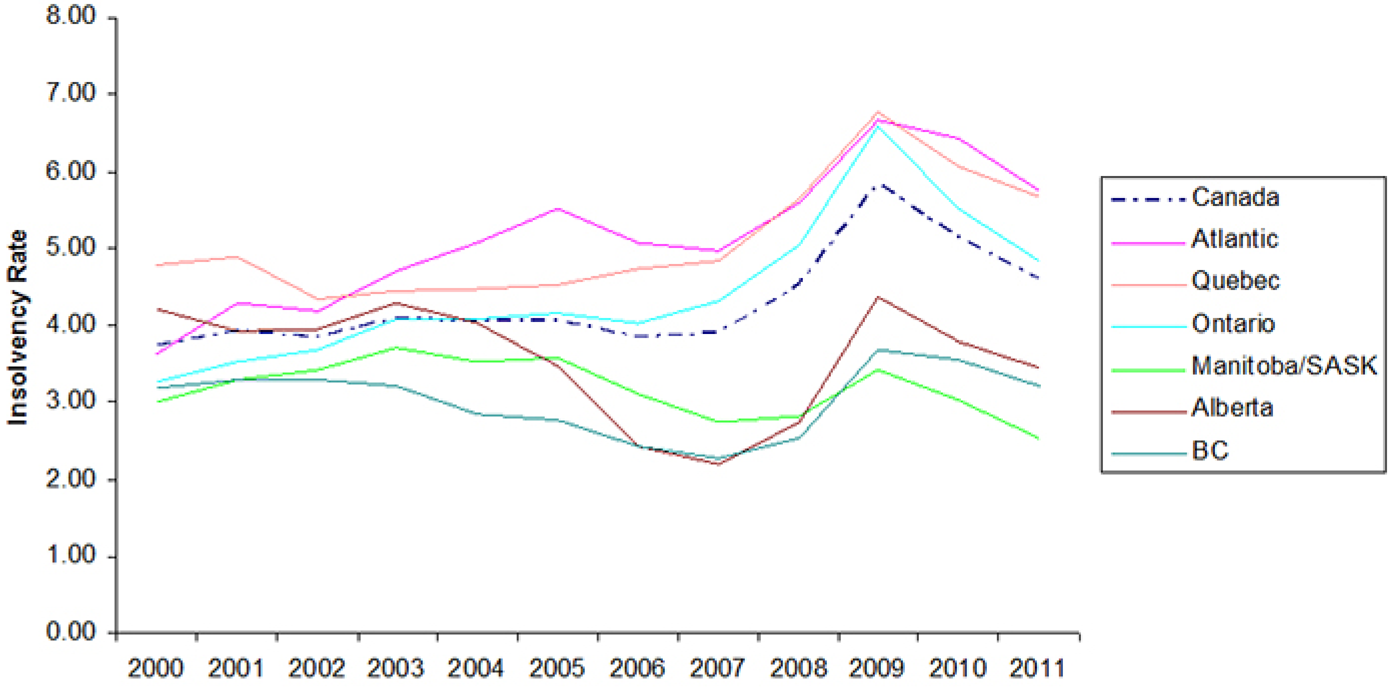
Figure 2: Insolvency Rates by Age Group



There is also significant regional variation in consumer insolvency rates. Between 2000 and 2012, the consumer insolvency rate has increased in Atlantic Canada, Quebec, and Ontario. There has been a better experience in Western Canada as the insolvency rates in Alberta and British Columbia have remained relatively constant while in Saskatchewan and Manitoba they have decreased slightly. Furthermore, the Atlantic Provinces, Quebec, and Ontario continue to have insolvency rates that are higher than the national rate, while the Western provinces and the Prairie provinces have rates that are lower than the national average.

The higher insolvency rates in Atlantic Canada, Quebec, and Ontario may reflect the underlying economic conditions compared to Western Canada. There is empirical support for the hypothesis that unemployment rates and the growth rates are significant in explaining the variation in insolvency filings.[8] For example, in recent years economic growth rates in Alberta, Saskatchewan, and Manitoba have been higher than the national average, while growth rates in Ontario, Quebec, and Atlantic Canada have been lower.[9] Additionally, Western Canada's unemployment rates are lower than the national average, while Atlantic Canada's unemployment rate is higher.[10]

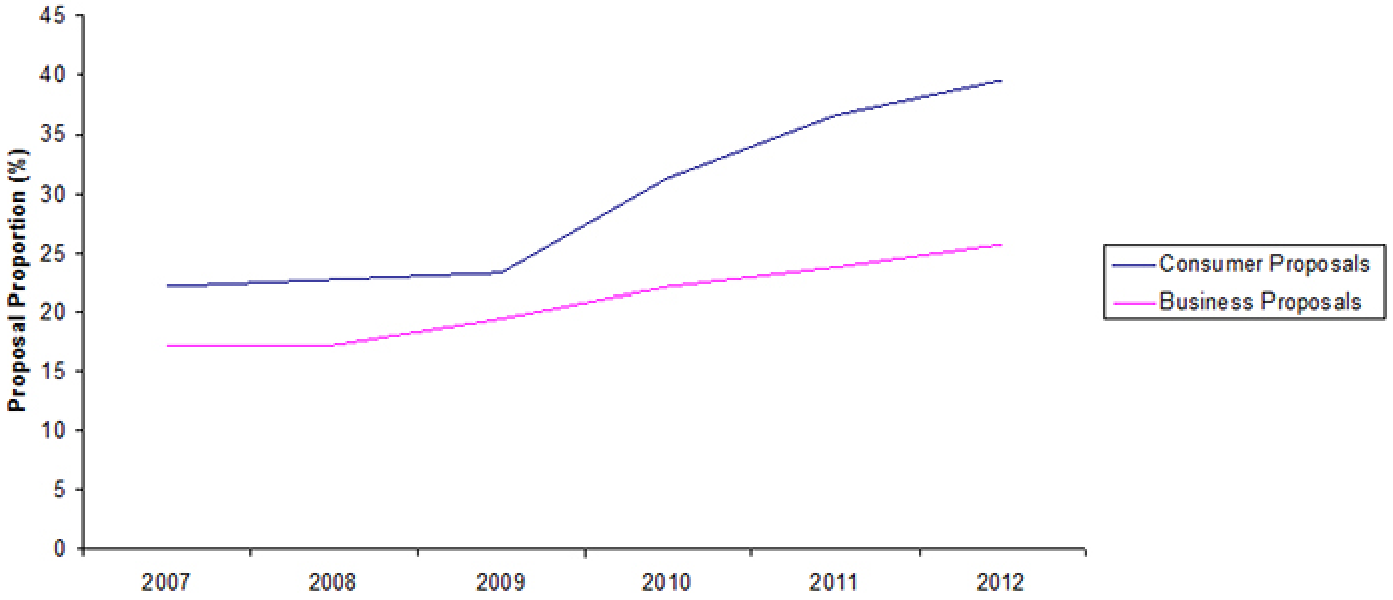
Figure 3: Consumer Insolvency Rates of Insolvency by Region



Growth in Consumer Proposals and Business Proposals

In recognition of the benefits of proposals for insolvent Canadians and their creditors, the 2008-2009 reforms were intended to encourage their use. Figure 4 illustrates the growth in consumer and business proposals under the BIA, as a percentage of total insolvency filings, since 2007. During the same period, the proportion of business proposals as a percentage of total business insolvency filings increased from 17.3% to 25.7%.

Figure 4: Proposal Growth - Consumer and Business Insolvencies



Conclusion

Insolvency laws touch on all aspects of economic life, both for consumers and businesses. They affect the ability of borrowers to access credit, the decisions of investors, and the level of disruption produced by the exit of inefficient firms from the marketplace. They also provide over-indebted consumers with an opportunity to obtain a fresh start and renewed financial health. As a result, it is important to Canada's overall economic performance that its insolvency legislation remains modern, effective and efficient.

In the consumer insolvency context, growing consumer debt levels and changes in demographic insolvency trends – which show that younger Canadians are less likely, and those between the ages of 45 and 54 are more likely, to become insolvent – suggest potential areas for policy focus. Emerging trends in commercial debt markets, including the growth in distressed debt trading and the use of derivatives to hedge economic risk, also suggest areas for policy consideration.

As Canada reviews its insolvency legislation, the overarching objectives of maximizing value, providing a balanced and equitable regime, and ensuring efficient and effective processes will form a base for the policy discussion.

Consumer Issues

Introduction

Individuals who encounter financial distress and are unable to service their debts may resort to insolvency proceedings (*i.e.*, bankruptcies or proposals) under the BIA. The consumer insolvency provisions are aimed at balancing the interests of debtors and their creditors.

In bankruptcy, the debtor's property, subject to certain limitations,[11] is liquidated by a trustee and the proceeds are distributed to his or her creditors. In return, a bankrupt is released from most types of debts.[12] Where the bankrupt has the financial means to contribute a portion of his or her income towards the outstanding debts ("surplus income"), the legislation requires them to do so. First-time bankrupts without surplus income are eligible for discharge from bankruptcy after nine months. The period before being eligible for discharge is longer for those bankrupts with surplus income and for those who have previously been bankrupt.[13]

Alternatively, the BIA provides insolvent debtors with the option of making a proposal to their creditors to repay, over a period of up to five years, all or a portion of what is owed. Proposals have the advantage of allowing the debtor to achieve financial rehabilitation while permitting them to retain assets that would otherwise be liquidated in a bankruptcy. For creditors, successful proposals typically offer a greater recovery than would be available in a bankruptcy.

Protection of Consumer Interests

Consumer Deposits

A retailer may receive payment before providing the contracted goods or services to the consumer. Questions of fairness arise if that retailer then becomes insolvent. The rights of buyers of prepaid goods and services are regulated to some extent by provincial consumer protection legislation, but in the absence of an insurance fund or other compensation, the consumer may become an unsecured creditor in the retailer's bankruptcy.

A consumer lien on the assets of insolvent retailers may protect consumers who have provided deposits or pre-payments. The Senate Committee in 2003 considered the merits of adding consumer liens to the BIA but recommended that the issue should continue to be governed by provincial legislation.[14] In the United States, consumer deposits are treated as preferred claims in bankruptcy for up to approximately US$2,250. The claims rank ahead of unsecured creditors' claims but behind secured claims.

Advocates for consumer liens assert that it is not possible for consumers to determine the financial condition of a retailer before making a deposit and that a consumer lien would provide protection similar to that given to unpaid suppliers. However, a preferred claim may not result in any meaningful recovery for the consumer as the retailer's assets may be subject to an existing secured charge. If the consumer lien ranked ahead of secured creditors, it would be more effective but lenders would likely react by reducing the availability, or increasing the cost, of credit to retailers to take into account the possibility of such liens ranking ahead of their security.

> *Stakeholders are invited to make submissions regarding whether, and how, Canada could enhance protection for consumer deposits either through consumer liens or, alternatively, through other mechanisms within the insolvency regime.*

Responsible Lending

The BIA provides that debtors' conduct can be subject to scrutiny in order to ensure fairness and integrity of the system. However, creditor behaviour may also contribute to financial difficulty for some Canadians. For example, credit granting practices such as extending credit on onerous terms to individuals who are unable to meet their existing financial obligations can lead to higher rates of insolvency. This may impact on existing creditors, whose recovery would likely be reduced due to the increased claims.

In the wake of the 2008 financial crisis, there have been increased calls for legislative intervention in the United States and other countries for "responsible lending" regimes that would impose certain duties on creditors before they extend credit and restrict the insolvency remedies available to those who did not meet these duties. Possible responses could include empowering the trustee or court to disallow the claim of a creditor where credit was extended improvidently or on unconscionable terms. Additionally, the lender could be required to disgorge payments made on such loans in the period leading up to a bankruptcy or proposal, similar to the treatment of preferences.

> *Stakeholders are invited to make submissions regarding whether, and how, the BIA could take into account creditors' conduct that has contributed to the financial difficulties or insolvency of a debtor.*

The "Fresh Start" Principle

One of the key objectives of the BIA is to enable an honest but unfortunate debtor to obtain a discharge from his or her debts, subject to such conditions as the court may see fit to impose. This is referred to as the "fresh start" principle. Limiting the fresh start principle are specified classes of debt that are not released by an order of discharge.[15] The exceptions are based on overriding public policy concerns[16] because the nature of the debt outweighs the benefit of the bankrupt being relieved of them.

Licence Denial Regimes

Licence denial regimes are used by certain creditors to continue collection efforts even though the debt was stayed and then released through the insolvency process.[17] For example, the regimes may permit a creditor to deny a driver's licence or vehicle registration unless full payment is received. The regimes relate almost exclusively to claims arising from the use of motor vehicles.[18] Creditors that rely on these regimes include insurance companies, provincial insurance regimes, electronic toll-highway operators and rental car companies.

Proponents of these regimes argue that they only encourage voluntary payment since driving is not a right and that debtors may choose to forgo the privilege of driving should they not be able to pay the debt in full. On the other hand, it has been argued that once insolvency proceedings are commenced these special collection tools are replaced with those available through the collective insolvency process. They may no longer be used as they interfere with the insolvency process and frustrate the debtor's ‘fresh start'.

There is greater clarity in the United States as the *Bankruptcy Code* expressly bars the use of these special collection tools to collect released debts.[19] In Canada, it has been left up to the courts.[20] In order to ensure consistent national treatment, Industry Canada is interested in the views of Canadians regarding this issue.

> *Submissions are invited as to whether amendments are required to the BIA to address the apparent conflict between the "fresh start" principle and the objectives of licence denial regimes.*

Reaffirmation Agreements

Reaffirmation agreements between a bankrupt and a creditor are those where the bankrupt agrees to pay a debt that was or will be released by a bankruptcy. Courts have recognized that bankrupts may reaffirm an obligation in one of two ways: 1) by conduct, where the bankrupt continues to make payments to a creditor under an agreement, or 2) by express agreement where the bankrupt enters into a written agreement with the creditor to repay an otherwise released debt.

There is no statistical evidence regarding the extent to which reaffirmation is taking place in Canada or whether the practice is being abused. Some commentators have called for greater regulation of reaffirmation on the grounds that it undermines the "fresh start" principle in insolvency. Reaffirmation by conduct (*i.e.*, continued payments) is of particular concern since bankrupts may reaffirm an agreement without realizing he or she is doing so. On the other hand, there may be compelling reasons why a bankrupt may want to voluntarily continue to pay a debt obligation (a common example is a car lease agreement, where the bankrupt requires the use of a car).

Reaffirmation of debts was raised during the last statutory review. The Personal Insolvency Task Force (PITF) in its 2002 report[21] recommended that reaffirmation agreements in respect of unsecured transactions be prohibited because they offend the "fresh start" principle and have the effect of giving one creditor preference over other creditors. However, the PITF recommended that reaffirmation be permitted for secured transactions on the ground that it allows the bankrupt to retain the assets covered by the security agreement and the secured creditor would be in the same position as they would have been if they had to enforce the security. Other stakeholders indicated the need for greater study into the scope and frequency of reaffirmation agreements before making any legislative changes on this issue.

> *Stakeholders are invited to make submissions regarding whether reaffirmation agreements should be regulated under the BIA, either through the mechanisms discussed above or through other mechanisms within the insolvency regime.*

Consumer Exemptions

Registered Savings Products

Successive governments have created initiatives intended to encourage Canadians to create long-term savings for various purposes. For example, Canadians may save for retirement through registered retirement savings plans (RRSPs), for children's post-secondary education expenses through registered education savings plans (RESPs) or for disabled persons' future financial security through registered disability savings plans (RDSPs).

In 2009, RRSPs were exempted from seizure in bankruptcy, subject to a clawback of contributions made in the 12 months before the filing. The goal was to protect retirement savings in a similar way to the protections afforded to registered pension plans, which are exempt from seizure in the event of bankruptcy of the holder of the pension. The exemption of RESPs was also examined in the last review. The Senate Report recommended that the BIA be amended to exempt RESPs from seizure in bankruptcy if: the RESP is locked in; and, RESP contributions in the one-year period prior to bankruptcy are paid to the trustee for distribution to creditors.[22] Largely because these conditions could not be met, which created a significant potential for abuse, RESPs were not exempted from seizure in an insolvency proceeding.

An RDSP is a long-term savings plan intended to assist Canadians with disabilities and their families to save for the future. Eligible parties may contribute any amount per year up to a lifetime contribution limit of $200,000. Government matching grants and bonds are also available to supplement the RDSP, depending on the amount contributed and the family income of the beneficiary.

RDSPs serve the public interest by encouraging savings for the support of people with disabilities. As a result, it has been suggested that they could be exempted from creditor claims in bankruptcy, similar to the protection provided to RRSP funds. Supporters of an exemption for RDSPs note that there are significant differences between RESPs and RDSPs that reduce the potential for abuse in bankruptcy. Unlike an RESP, only individuals who claim the disability tax credit under the *Income Tax Act* qualify for an RDSP and there can only be one account for that person. Furthermore, only a parent, legal guardian or trust institution may open and contribute to the RDSP and only the beneficiary can access the funds. It is possible, however, that exempting RDSPs could create the potential for abuse that adversely impacts other creditors' interests.

> *Stakeholders are invited to make submissions regarding the treatment of registered savings products in bankruptcy.*

Federal Exemption Lists

Generally, a bankrupt's property is liquidated by a trustee and the proceeds are distributed among the creditors according to the distribution scheme set out in the BIA. Certain property is, however, exempt from distribution to creditors. The exemptions are set by provincial/territorial law.

Stakeholders have questioned whether it would be more appropriate to have a federal exemption list that would apply to all personal bankruptcies regardless of the bankrupt's province of residence or, alternatively, would permit the bankrupt to choose between the federal and provincial exemption list.

In the last statutory review, the Senate Report and the PITF Report recommended that there be a federal exemption list that the debtor can select in preference to the otherwise applicable provincial or territorial exemptions. The issue of whether to develop a federal exemption list was not addressed in the 2008 and 2009 insolvency reforms.

A federal exemption list could create a minimum standard available to all bankrupts. On the other hand, if it varies significantly from existing provincial/territorial exemption lists, it could create uncertainty for creditors who would not know which list a bankrupt would select.

> *Submissions are invited as to whether the introduction of a federal list of exemptions should be considered.*

Protecting Families

Equalization Claims

Marriage breakdown and insolvency are often closely linked as marriage breakdown can often be a trigger for insolvency proceedings.[23] The special nature of some family law debts has been recognized in insolvency law. Under the BIA, a specified portion of unpaid child and spousal support is treated as a preferred claim and is paid ahead of the claims of unsecured creditors.[24] Also, family support obligations are not released by the bankrupt's discharge.[25]

With respect to family assets, most provinces use the "division of property" approach. Divorcing spouses are deemed to have an inchoate claim to half of the family assets which are then divided between the spouses. In the case of exempt assets, bankruptcy has no impact on such divisions as the inchoate claim is not a money claim that would be stayed or released by the bankruptcy.

Ontario, Manitoba and Prince Edward Island use an "equalization" approach under which spouses are entitled to keep property held in their own names but share any increase in the value of marital property that occurred during marriage. Usually this means one spouse must make an equalization payment to the other spouse. Under provincial law, such a payment is considered to be a debt owed by one spouse to the other and is treated as an unsecured claim in an insolvency proceeding.

In *Schreyer*[26], the Supreme Court of Canada found that if the paying spouse becomes bankrupt, an equalization payment may be released in the bankruptcy. As a result, the non-bankrupt spouse was not entitled to payment of the equalization claim while the bankrupt spouse was entitled to keep the exempt property, which was the family farm. The Court noted the apparent injustice and suggested there should be better protection for equalization payments in the event of bankruptcy to avoid such inequitable results.[27]

> *Submissions are invited as to whether, and how, bankruptcy legislation could be amended so as to improve the status of equalization payments in bankruptcy.*

Family Support Claims and the Levy

Bankruptcy provides an efficient collection mechanism for creditors as they may rely on the collective remedies available to the trustee to satisfy their claims. In order to offset the costs of the OSB, the regulator responsible for protecting the integrity of the bankruptcy system, a levy is applied to all payments made by a trustee.[28] The levy is typically five percent of payments.[29]

Subject to certain conditions, family support claims are provable claims under the BIA.[30] This means that a creditor may file a proof of claim and receive a dividend out of the estate. Family support claimants may receive treatment that is preferential to other creditors, to a specified extent, as a portion of their claims may be paid in priority to the claims of other unsecured creditors.[31] The claims also survive the bankruptcy process, meaning that they are not released when the bankrupt receives his or her discharge.[32] The practical impact is that family support claimants can expect to receive greater recovery through the BIA process than other unsecured creditors and they are also entitled to collect the remaining indebtedness post-bankruptcy without competing with creditors whose claims have been released.

As a result of the *Cameron* decision, in which the court held that "the levy is to be shared by all creditors who benefit from the proceedings,"[33] family support creditors must give the bankrupt credit for amounts paid in respect of the levy. Some stakeholders have suggested, however, that not all section 178 creditors credit the bankrupt for the amount of the levy, resulting in an inequitable situation where some section 178 creditors obtain full payment and others do not.

> *Submissions are invited as to the treatment of section 178 creditors with respect to the Superintendent's levy.*

Vesting of Family Property Claims

Upon bankruptcy, all property of the bankrupt at that date and any property that may be acquired by or devolve on the bankrupt before his or her discharge, with certain exceptions, vests in the trustee for distribution among the bankrupt's creditors. Property can include the bankrupt's right to sue a former spouse for an equalization claim or for the division of matrimonial property.

In the last statutory review, the Senate Report recommended that the right to sue the bankrupt's spouse for equalization or division of property under provincial/territorial matrimonial property law be excluded from property vesting in the trustee.[34] The Senate Committee heard that the trustee often settles the claim at a significant discount. As a result, the non-bankrupt spouse retains most of the bankrupt spouse's share of the family assets and the creditors receive very little from the settled claim. Moreover, confidence in the insolvency system may be undermined.[35]

Stakeholders have recommended that the right to sue remain with the former spouse but that any proceeds obtained from the action be considered property to be distributed among the creditors.

> *Stakeholders are invited to make submissions regarding the treatment of the right to sue a former spouse for an equalization claim or the division of property as property vesting in the trustee.*

Joint Debts

Section 142 of the BIA addresses the distribution of property when partners become bankrupt. The section is intended to deal with business situations involving partnerships, not matrimonial situations. Some stakeholders have raised the concern that parties may attempt to apply s.142 in matrimonial situations which could have the effect of distorting the distribution of property that would otherwise take place.

> *Submissions are invited as to whether s.142 should be amended to restrict its application to business partnerships.*

Treatment of Student Loans in Bankruptcy

Discharge of Student Loan Provisions

The federal and provincial governments have implemented student loan programs intended to assist full- and part-time post-secondary students pay for higher education and training. Since these loans are granted on need rather than ability to repay in the event of bankruptcy they are treated differently than other debts under the BIA. In 1997, the BIA was amended to create a two-year waiting period from the time a student ceased to be a full- or part-time student before the loan could be released in bankruptcy. In 1998, the waiting period was increased to 10 years. It has been noted that students typically benefit from the educational opportunities that are facilitated by the government student loans and that the loans are eligible for interest relief, debt forgiveness and other relief under the terms of the student loan program. Accordingly, many stakeholders recognize that the release of student loans in bankruptcy should be subject to special rules, including a waiting period.

The Senate Report recommended a waiting period of five years or, in the case of hardship, a waiting period of less than five years. The Senate heard from stakeholders that the 10-year waiting period created "a period of social atrophy" as the debtor could neither afford to pay the debt, nor to move on from it through the normal means of bankruptcy.[36] In 2009, the BIA was amended to reduce the waiting period from 10 to seven years or, in the case of significant financial hardship, from 10 to five years. Some stakeholders suggest that the seven- and five-year waiting periods still impose too high of a burden.

> *Stakeholders are invited to make submissions regarding whether the current provisions regarding the release of student loan debts should be amended.*

Hardship Discharge

Under the BIA, release of government-funded student loans can be granted on grounds of hardship if the debtor satisfies the court of good faith towards repayment of the loan and that the bankrupt is experiencing and is likely to continue to experience financial difficulty that prevents repayment of the student loan debt. An application for discharge on the basis of hardship may only be made after at least five years have elapsed from when the student ceased to be a full- or part-time student.

In an effort to assist those who demonstrate financial need, however, the Canada Student Loan Program offers several repayment assistance measures. For example, it offers eligible students relief measures such as (a) the Repayment Assistance Plan, (b) the Repayment Assistance Plan for Borrowers with a Permanent Disability, and (c) the Severe Permanent Disability Benefit.[37]

Some stakeholders have suggested that, despite relief measures available under student loan programs, the five-year waiting period in the case of hardship is unwarranted. They argue that obtaining debt relief can be difficult and that, in any event, a hardship discharge is only available if the debtor convinces a court that the hardship is a continuing event that will prevent payment in the future. In their view, this removes the need for a waiting period.

> *Stakeholders are invited to make submissions regarding the current hardship discharge provisions.*

Partial Release of Debts

Under the hardship discharge provision,[38] the courts have found that they do not have the authority to order a release of part of the student loan debt; either all or none of the debt is to be released by court order. Some stakeholders have suggested that it may be appropriate to give the courts more discretion to release a portion of debt where warranted.

> *Stakeholders are invited to makes submissions regarding possible flexibility for court-ordered partial discharges on hardship grounds, including any factors the court should consider in exercising its discretion.*

Commercial Issues

Introduction

In the commercial insolvency context, debtors and creditors have numerous options for dealing with severe financial distress. The BIA provides a rules-based framework for bankruptcy and proposals (e.g. restructuring) by businesses of any size. The CCAA provides a more flexible court-driven framework for reorganizations by companies with at least $5 million in debt. Secured creditors may also opt to put in place a receivership in many circumstances. Corporations have also increasingly been turning to arrangement provisions under corporate legislation, such as the *Canada Business Corporations Act*.

The 2008-2009 reforms were designed to encourage restructurings of viable but financially-distressed firms because the benefits of a successful reorganization include the likelihood of greater returns to creditors than in bankruptcy, preservation of jobs and relationships with suppliers and lenders, and ensuring that assets remain productive to the overall benefit of the Canadian economy.

The Sarra Report

During summer 2011, Dr. Janis Sarra[39] conducted eleven public hearings regarding Canada's commercial insolvency regime. This work was supported by the Canadian Insolvency Foundation. Based on the hearings, Dr. Sarra published a report titled "Examining the Insolvency Toolkit: Report of the Public Meetings on the Canadian Commercial Insolvency Law System"[40] (the "Sarra Report").

Industry Canada greatly appreciates the contribution made to the Canadian public policy debate by Dr. Sarra and all of those who participated in the public hearings.

Encouraging Innovation through Intellectual Property Rights

Creating an economic climate that encourages innovation is considered a vital component of a country's long-term competitiveness. Intellectual property (IP) rights, such as patents and copyrights, play an important role in promoting innovation. IP statutes promote innovation through the incentive of a temporary monopoly and at the same time ensure reasonable access to users, and preserve marketplace integrity (e.g. trade-marks). IP laws focus on the rights of creators and licensees, while insolvency laws focus on the interests of debtors and creditors. However, as economic framework legislation, both IP law and insolvency law can promote innovation and marketplace integrity by mitigating entrepreneurial risks. Insolvency law can provide investors with commercial certainty in the case of default, which facilitates investment in the development of innovative ventures, as well as businesses that rely on the authorized use of IP through licences.

Copyright and Patented Items

There are existing provisions in the BIA regarding rights of holders of patents[41] and copyrights.[42] It has been suggested that these provisions should be modernized, to better reflect the importance of IP rights in the Canadian economy. For example, the provisions related to copyright speak of "manuscripts" that have been "put into type". The archaic language creates difficulties when the copyright in question is software, for example.

Additionally, some stakeholders have called for greater rights for IP producers and creators in insolvency proceedings, enhancing the limited rights that currently exist. For example, it has been suggested that the protection for patentees could be extended to other IP, such as trade-marks. It has also been suggested that the bankruptcy provisions be extended to CCAA restructurings and receiverships.

2009 Amendments – Rights of IP Licensees

Effective licensing rights are essential to a robust IP marketplace, as licensing gives innovators a way to monetize their works and release the innovation into the marketplace during the IP's period of statutory protection. Legislative amendments in 2009 were aimed at reducing the uncertainty faced by IP licencees in an insolvency restructuring. The reforms expressly permit the disclaimer of IP licences, in order to give debtors and the courts the flexibility to restructure. However, IP licencees may preserve their rights to use the IP as long as they continue to perform their obligations under the licence.

The reforms were viewed as a positive step forward but some commentators have observed that there are outstanding issues regarding IP licences in insolvency. For example, the licencee protection only applies if the licensor restructures but not in bankruptcy or receivership. Others have noted that the new provisions only refer to the licensee's "right to use" the IP in question and do not require the licensor to provide upgrades or maintenance of the technology that may have been included in the IP licencing agreement. It has been noted that, while the amendments protect a licensee against a disclaimer, an insolvent licensor could sell IP free and clear of current licenses. Some commentators have called for additional legislative guidance to assist in this judicial balancing of interests.

> *Submissions are invited regarding how to improve the existing rules to support the objective of encouraging innovation, while also balancing the competing interests in an insolvency proceeding.*

Encouraging Restructuring

Streamlining *Companies' Creditors Arrangement Act* Proceedings

The CCAA sets out a court-driven insolvency proceeding. In order to commence a CCAA proceeding, an initial court order is required. Typically, the order provides for a stay of proceedings against the debtor company, appoints a monitor and sets out the rights and powers of the debtor company during the proceeding, including the ability to carry on business, sell assets and terminate employees. It may also provide for interim financing in order to provide liquidity to fund operations during the proceedings. The debtor company typically returns to the court for approval of various steps in the restructuring process, such as the sale of assets, settling contentious claims or dealing with out-of-the-ordinary-course transactions. Finally, court sanction of a plan of arrangement and distribution of assets to creditors is required.

Concerns have been expressed by stakeholders regarding the complexity and cost of CCAA proceedings. The following issues have been raised as areas of concern in existing practice.

Initial Orders

Some stakeholders have expressed the concern that initial orders can be too broad, which can negatively affect creditors since it may be difficult to successfully challenge decisions that have been acted upon (*e.g.*, where interim financing has been accessed by the debtor). Some stakeholders have suggested that a short automatic stay period (*i.e.*, five to 15 days) followed by an initial court appearance may provide more creditors with the opportunity to appear before the court. The automatic stay could provide limited authority to ensure the debtor company is able to "keep the lights on". Alternatively, the statute could restrict an initial order to what is necessary to allow the debtor to carry on business for a short period until there is a court hearing or notice to creditors.

> *Stakeholders are invited to make submissions regarding the breadth of initial orders and potential options for streamlining the process.*

Claims process

In CCAA restructurings, the time and cost associated with resolving claims can be prohibitive. Some stakeholders have suggested that a default mechanism for determining claims may be appropriate, particularly in smaller CCAA proceedings. The Sarra Report notes that in Alberta the monitor or a court-appointed claims officer determines the amount of claims owing and that amount is accepted unless the creditor objects within a specified period.[43]

> *Stakeholders are invited to make submissions regarding the existing claims process and whether consideration should be given to a default process.*

Court Applications

Significant resources can be dedicated to court applications in many larger CCAA proceedings. The consequence is increased cost for all parties and potentially reduced recovery for creditors. Some stakeholders have suggested that the debtor company could be statutorily authorized to take specified actions or the monitor could be authorized to approve certain actions by the debtor without requiring court sanction. It has also been suggested that the monitor could be granted more authority to mediate or settle disputes.

> *Stakeholders are invited to make submissions regarding the existing role of court appearances in CCAA proceedings and whether consideration should be given to possible approaches to reduce the number and cost of such court appearances.*

Balancing Competing Interests

Role of Unsecured Creditors

Unsecured creditors can be diverse and unorganized, making it difficult for them to have an effective voice in a corporate restructuring. Some stakeholders have suggested that a mandated committee, with professionals paid for by the debtor, could create a more balanced playing field. Other stakeholders, however, have suggested that unsecured creditors' committees would simply create further delays and increase costs (see, for example, Professional Fees in CCAA proceedings below). Some view the existing provisions, which authorize the court to appoint professionals to represent specific creditors, as sufficient.

> *Stakeholders are invited to make submissions regarding the effectiveness of the existing provisions and other potential mechanisms to ensure an effective voice for unsecured creditors in restructuring proceedings.*

Acting in Good Faith

The Sarra Report suggests that since there is no obligation on parties in a CCAA proceeding to act in good faith, creditors may take positions during the bargaining process that they know have little chance of being approved but that will improve their position relative to other creditors. It is suggested that such strategies have the potential to undermine the integrity of the insolvency system and a constructive bargaining process.[44]

> *Stakeholders are invited to make submissions regarding whether the CCAA should expressly address whether parties to proceedings have a duty to act in good faith.*

Eligible Financial Contracts

Under the BIA and CCAA, eligible financial contracts (EFCs) enjoy "safe harbour" provisions that permit them to be terminated, netted and have collateral realized despite the stay of proceedings that may be ordered by the court. These "safe harbours" were implemented in order to ensure a proper functioning derivatives market and to reduce systemic risk. Protections were also put in place in the BIA and CCAA to prevent an insolvent debtor from terminating or assigning an EFC as they could potentially do with other contracts.

The Insolvency Institute of Canada issued a report on derivatives[45] that recommended several actions be taken with respect to EFCs. First, it was recommended that the insolvent party, the trustee, the receiver or the liquidator be permitted to terminate or assign EFCs, subject to certain restrictions. It was also recommended that "walk-away" clauses, which permit a solvent counterparty to refuse to make net termination payments owing to the insolvent party in the event of an insolvency, should be rendered ineffective. The report also recommended that financial collateral securing an EFC be exempted from the existing deemed trusts (e.g. for employee withholdings) and super-priorities (e.g. for unpaid wages, pension contributions). At the same time, the report recommended that financial collateral should be limited to assets that are no longer under the control of the insolvent party, either through assignment or pursuant to a title transfer credit support agreement. The report also recommended that similar rules be applied in receiverships.

On this issue, the Sarra Report suggested EFCs, such as credit default swaps (CDS), may lead to an uncoupling of legal and economic interests and may change creditor behaviour. The Sarra Report also suggests that consideration be given to new types of derivatives that have emerged in recent years that do not fit within the original intention of the EFC safe harbour provisions.[46] The Sarra Report noted that derivatives could be made subject to the CCAA stay of proceedings, except with leave of the court, and that a process could be put in place to determine whether particular EFCs should be stayed or disclaimed.[47]

> *Stakeholders are invited to make submissions regarding eligible financial contracts, and their impacts on insolvency and restructuring proceeding, as well as potential policy responses.*

Professional Fees in CCAA Proceedings

The issue of professional fees in large corporate insolvencies has received increased attention from stakeholders and insolvency professionals in Canada and elsewhere. Reliable data regarding professional fees in Canadian insolvency proceedings are not currently available. Concerns have been raised that the expense of CCAA proceedings has been growing and may deter businesses use of insolvency proceedings in favour of alternatives that may not properly protect the interests of all creditors and stakeholders. Some stakeholders have also raised concerns that elevated professional fees can harm creditors' recoveries.

Under the CCAA, the court is responsible for reviewing fees charged to the debtor company to ensure they are "fair and reasonable". Parties to the proceeding are entitled to challenge fee applications and the court may reduce or reject fees where warranted. There is no obligation to report professional fees to the OSB or other parties, although they are available in the court record.

Other countries are examining the impact of professional fees on their respective insolvency systems, and the potential role of regulators and professional bodies. For example, in the United States, a guideline regarding attorneys' fees in larger Chapter 11 cases came into force on November 1, 2013.[48] Among other things, legal firms must disclose their non-bankruptcy blended hourly rate, hours and fees per task, and make their billing data available to the court, the U.S. Trustee and major parties to the proceeding. The guideline also sets out approaches for examining fees to ensure they are appropriate. The United Kingdom[49] and Australia[50] are also examining this issue.

> *Stakeholders are invited to make submissions regarding the impact of professional fees on insolvency proceedings, including the utility of greater disclosure practices.*

Enhancing Transparency

Creditor Lists

Currently, the CCAA requires the monitor, within five days after an initial order is made, to prepare a list of creditors and to make it publicly available.[51] The Sarra Report raised the idea of requiring the debtor company to continuously maintain and disclose a creditor list in order to provide more transparency regarding interested parties in the proceeding.[52] Unsecured creditors, such as trade creditors and suppliers, may be able to use the information to better organize. It could also provide information about creditors that can assist in formulating bargaining positions. However, some stakeholders noted that developing and updating a creditor list can be time consuming and expensive, especially if there is active debt trading. This could have the effect of distracting the debtor company from its primary objective of achieving a successful restructuring.

> *Stakeholders are invited to make submissions regarding imposing an obligation on the debtor company to maintain a creditors' list during a CCAA proceeding.*

Empty Voting and Disclosure of Economic Interests

Under the CCAA, creditors have the right to vote on a plan of arrangement or compromise, based on the expectation that they have an economic interest in the success of the restructuring. Stakeholders, however, have raised concerns that as a result of changes in the marketplace, not all creditors may have the same incentives to support a restructuring. In particular, stakeholders have raised concerns regarding the impact of the trading in distressed debt and the potential effects of credit default swaps on creditor incentives and decision making.

Distressed debt trading, in which existing debt is sold at a discount by initial creditors to speculative purchasers, has played an increasingly prominent role in CCAA restructurings. On a positive note, the distressed debt market gives initial creditors an opportunity to fix their losses at an early stage and exit the insolvency proceeding. On the other hand, through purchases of debt at a discount, the purchaser can acquire a more significant voting position than warranted by their economic exposure. At the same time, distressed debt purchasers may hold short-term objectives that run counter to the objective of restructuring the debtor.

Credit derivatives are a form of financial instrument that allow creditors to hedge against credit exposure and that may allow speculators to bet against a particular firm. Credit default swaps (CDS) are a common form of derivative to protect against credit loss, in which a buyer obtains protection from the seller in case of a "credit event", such as default, restructuring or bankruptcy, for a fixed period. Unlike traditional credit insurance, the amount of compensation that can be claimed under a CDS is not limited to the actual loss suffered, there is no automatic right of subrogation and the CDS buyer or seller is not required to hold an actual interest in the hedged debt. It has been suggested that given these characteristics of a CDS, a creditor who holds CDS positions may have disincentives to support a workout or restructuring. Alternatively, a CDS holder may have different incentives in a restructuring proceeding than an unhedged creditor. The lack of transparency with respect to CDS holdings can mean that the restructuring company and unhedged creditors may be unaware of the motives of hedged creditors and their incentives with respect to the outcome of the restructuring process.

It has been suggested that the potential for misalignment of creditors' interests caused by distressed debt trading and credit derivatives, including CDS, may be mitigated by empowering the court to take account of actual economic interests when considering approval of a restructuring plan. Additionally, increased disclosure requirements could provide other creditors with vital information to understand and respond to the incentives of hedged creditors. Others have stated that disclosure and consideration of true economic interests instead of nominal debt holdings could lead to potential negative repercussions in the distressed debt and credit derivative markets.

> *Stakeholders are invited to provide input on whether courts should be empowered to require greater disclosure of creditors' actual economic interests or to take account of those interests.*

Role of the Monitor

Under the CCAA, an insolvency professional is appointed to monitor the business and financial affairs of the debtor (the "monitor").[53] As described in the Sarra Report:[54]

> *"Monitors are relied on by the courts and the parties to provide information and their views on the financial condition of the debtor, the efficacy and fairness of sales processes or DIP financing arrangements, and their impartial opinion on a host of other issues that arise during the proceeding. Integrity and independence are hallmark attributes of a good monitor."*

In 2009, the role of the monitor received statutory clarification, with particular focus on the duty to provide notice to stakeholders and informed guidance to the court.[55] The Superintendent of Bankruptcy also became the regulator for monitor conduct, and a detailed professional conduct regime was added to the CCAA.[56] As noted in the Sarra Report, the role of the monitor is continuing to evolve.[57]

Pre-Filing Reports

A relatively new development is the monitor's "pre-filing report", which is a description of the debtor company's affairs up to the date of a CCAA filing. The report is prepared for the purposes of the initial application and, hence, prior to the monitor's appointment. Pre-filing reports have been found by the courts and insolvency professionals to be beneficial, as they provide timely information to the court. It has been suggested, however, that the monitor's ability to exercise the requisite attribute of independence, prior to receiving a court appointment, is debatable. It has also been suggested that monitors be precluded from introducing evidence in pre-filing reports.

> *Stakeholders are invited to make submissions regarding whether pre-filing reports should be permitted and, if so, in what circumstances.*

Conflict of Interest

The court, creditors, and other stakeholders rely on the monitor to maintain an impartial perspective when providing information on the restructuring process. However, in some CCAA restructurings, the monitor has a pre-existing relationship with the debtor company, for example having acted as the debtor company's financial advisor, which can raise questions as to the monitor's independence.[58] In larger CCAA cases, the debtor company often has separate financial advisors who act independently of the monitor, thereby reducing the potential for real or perceived conflicts of interest. In small- to medium-sized CCAA cases, however, the monitor has often acted as the debtor company's financial advisor pre-filing, raising concerns as to the monitor's impartiality. Some commentators have suggested that such a pre-filing relationship can facilitate a successful restructuring and reduce costs, as the monitor already has knowledge of the debtor company's financial situation. Further, the risks of conflicts are mitigated by the fact that monitors are professionals that are subject to various forms of oversight: they must comply with professional codes of conduct,[59] are subject to appointment restrictions,[60] and are also subject to oversight by the OSB and the court.[61] Others have noted that while a monitor that has acted as a financial advisor to the debtor company may improve the efficiency and reduce the costs of a CCAA restructuring, further measures such as disclosure of the monitor's relationship with the debtor company may be necessary in addition to OSB and court oversight.

> *Stakeholders are invited to make submissions regarding whether additional measures are necessary to address the potential for conflicts of interest where a monitor has a pre-filing relationship as financial advisor to a debtor company.*

Asset Sales

Credit Bidding

Credit bidding refers to the ability of a creditor to use a claim as a form of currency during asset sales in an insolvency proceeding. Canadian legislation is silent regarding credit bidding, but courts have permitted it.[62] The *United States Bankruptcy Code* specifically provides that a lien holder may bid its allowable claim in a sale of the property unless the court orders otherwise.[63]

The Sarra Report notes concerns inherent to credit bidding, particularly with respect to imbalances of power in favour of, and information available to, secured creditors. Such imbalances could reduce the likelihood of competing bids, thereby reducing the potential value of the assets being sold.[64]

> *Stakeholders are invited to comment on whether credit bidding should be permitted and, if so, what limitations may be appropriate.*

Stalking Horse Bids

A stalking horse bid is an initial bid that sets a minimum floor for the eventual sale of assets. While insolvency legislation is silent regarding such bids, Canadian courts permit this type of sales process regularly.

The Sarra Report suggests that stalking horse bids deliver "the message day one to customers, suppliers, employees and other key stakeholders that the business will carry on, and that there is an informed party that has faith in and is committed to the business."[65] It also notes that courts have considered four criteria in assessing a stalking horse bid process: the degree of control exercised over the initial stage to determine the stalking horse bidder; the need for a stalking horse bid as opposed to a traditional sales process; the economic incentives (break fees and other protections) granted to the bidder; and, whether sufficient time is permitted for other bidders to consider topping the credit bid.[66]

> *Stakeholders are invited to comment on whether stalking horse bids should be expressly permitted under Canadian insolvency legislation and, if so, what limitations may be appropriate.*

Applicability of Asset Sale Test

Asset sales are subject to court approval if they are made outside of the ordinary course of business.[67] Some stakeholders have suggested that it is unclear when sales are material enough to become exposed to the court approval process. Because court approval of sales outside the ordinary course of business must take into account how the sale could impact on the payment of wage and pension claims,[68] stakeholders have suggested a materiality test should be created to ensure court approval is sought when appropriate.

> *Stakeholders are invited to comment on whether a materiality test is required to determine when asset sales will be subject to court approval.*

CBCA Arrangements

The *Canada Business Corporations Act* (CBCA) permits a corporation to undertake an "arrangement" in order to effect a corporate change that would not be feasible under any other provision of the Act.[69] Typically, an arrangement is used to conduct a series of changes to a corporation's structure, including mergers, amalgamations and divestitures. In recent years, arrangements have been used to restructure the affairs of insolvent corporations.

The reasons for choosing to restructure under the CBCA rather than insolvency legislation may include the speed and flexibility under which an arrangement can be accomplished; that the debtor's management remains in control of the corporation; that there is no oversight by an independent party such as a monitor; that there are no reporting or other requirements to creditors; and, that it avoids the stigma associated with insolvency.

The CBCA requires that the corporation effecting an arrangement be solvent. Courts have interpreted this to mean that the applicant corporation need be solvent but other affected corporations may be insolvent. As such, some corporations have bypassed the solvency requirement by creating a solvent shell company that is then used as the applicant.[70]

The Director under the CBCA has published a policy statement regarding the use of CBCA arrangement provisions by financially distressed corporations which indicates that corporations must be in compliance with the solvency provisions of the legislation.[71]

Stakeholders have expressed concern with the CBCA arrangement provision because it is skeletal, providing the court broad discretion to make "any interim or final order it thinks fit".[72] As a result, there may be insufficient protections for creditors and a general lack of safeguards compared to insolvency legislation, which strives to balance the competing interests of various affected parties. It has been suggested that insolvency-type protections could be incorporated into the CBCA arrangement provisions. Alternatively, the Sarra Report suggested that it may be appropriate to consider changes to the CCAA in order to respond to the issues that drive parties to use the CBCA.[73]

> *Stakeholders are invited to provide input regarding the practice of CBCA arrangements involving insolvent companies.*

A Streamlined Small Business Proposal Proceeding

The cost of the existing Division I proposal process may be significant and can be prohibitive in the context of small- and medium-sized enterprises (SMEs). It may be appropriate to consider creating a simplified and less expensive proposal process intended to make it easier for SMEs to restructure. Some stakeholders have suggested that certain steps in the process could take place automatically (e.g., 45-day extension of the stay of proceedings), subject to creditors' rights to object.[74]

> *Stakeholders are invited to make submissions regarding whether a simplified, less expensive proposal process for SMEs would be warranted.*

Division I Proposals Extension

A Division I proposal must be filed within six months of the filing of a notice of intention.[75] It has been suggested that the time limit may hinder the debtor's ability to obtain creditor approval, particularly in more complex commercial proceedings.[76] Some stakeholders have suggested permitting the court to extend the time limit in exceptional circumstances where clear criteria exist for granting an extension.[77] On the other hand, other stakeholders have expressed concern that it could lead to abuse of the stay if the length of proceedings is too long.

> *Stakeholders are invited to provide input on extending the time for filing a Division I proposal following the filing of a notice of intention to file a proposal.*

Liquidating CCAA Proceedings

The CCAA was originally envisioned as a restructuring tool. In recent years, courts have noted an increase in the number of liquidating CCAA filings,[78] meaning that the Act is used to sell the assets – typically as a going concern business – and proceeds are distributed among the creditors. Stakeholders have expressed concern with the appropriateness of liquidating CCAAs because there is often no opportunity for creditor approval. Additionally, there can be pressure on the court to approve sales as there is no other going-forward solution. The sales may avoid many of the checks and balances provided by the plan approval process.

Some stakeholders have expressed the view that if liquidating CCAA proceedings are to continue, the CCAA should provide protections and add principles for the court to consider in determining whether to approve the sales processes. Other stakeholders have strongly supported maintaining judicial flexibility to permit the tailoring of appropriate solutions in the particular circumstances of the case.

> *Stakeholders are invited to provide input on whether the CCAA should be amended to codify protections for stakeholders and principles for the courts to consider in liquidating CCAA proceedings.*

Enhancing Equity

Employees' Claims

Notable commercial insolvencies, including Nortel Networks and AbitibiBowater, have raised concerns about debts and obligations owed to employees, former employees and pensioners (together referred to as "employees"). Employees' claims can include unpaid wages, vacation pay, severance and termination pay, long-term disability benefits, pension obligations as well as other employment benefits, such as dental, drug and extended healthcare plans.

Currently, employees benefit from numerous legislative and regulatory protections, as well as government programs, not available to other creditors:

- In bankruptcy and receivership:
  - **Pre-filing unpaid wages and vacation pay** are granted a super-priority over cash, accounts receivable and inventory for up to $2,000 per employee,[79] plus up to $1,000 super-priority for disbursements incurred as part of their employment:[80]
    - To the extent such claims are unfulfilled by the super-priority, they are granted a preferred claim over all of the debtor's remaining property;[81]
  - **Unremitted normal cost pension contributions** are granted a priority over secured creditors without limit;[82]
- In restructuring proceedings, a proposal or plan of arrangement or compromise must provide for the payment of:
  - **Pre-filing unpaid wages and vacation pay** of up to $2,000 per employee;[83]

    - **Post-filing wages, vacation pay and disbursements**;[84]
    - **Unremitted normal cost pension contributions**;[85]
- The federal Wage Earner Protection Program (WEPP) pays eligible workers up to approximately $3,600 for **unpaid wages, vacation pay, and severance and termination pay**. The WEPP is subrogated to the employees' claim for up to the amount of the super-priority;
- The BIA and the CCAA both respect the **pension fund trust** created under federal or provincial pension legislation, meaning that the amounts held in that pension fund trust are only available to pensioners and are not available to other creditors;
- The federal government announced as part of Budget 2012 that federally-regulated employers that offer **long-term disability plans** will need to do so pursuant to insurance rather than self-funding, meaning that an employer's failure would not affect such benefits.

In recent years, there have been calls to increase protections for employees. For example, it has been suggested that severance and termination could be included in the definition of wages, as they are currently excluded. It has also been suggested that the existing cap of $2,000 on unpaid wages could be increased or removed entirely, permitting employees to obtain priority for the entirety of their claim. With respect to pensions, some stakeholders have suggested that defined benefit pension plan deficits be prioritized, either ahead of secured creditors (i.e. a super-priority) or ahead of unsecured creditors (i.e. a preferred claim). With respect to employee benefit plans, it has been suggested that amounts owed with respect to these plans be prioritized or that the company be barred from terminating such plans without court approval.

International comparisons are imperfect due to differences in employees' claims and how such claims are treated in insolvency proceedings. Industry Canada research[86] found that, of the member countries of the Organisation for Economic Co-operation and Development (OECD) for which information was ascertainable, most – like Canada – provide some form of priority for employees' remuneration in insolvency proceedings. In almost all cases, the insolvency priority is capped either in amount, by a specified time period, or both. Many countries also offer a wage guarantee fund similar to the WEPP. With respect to pensions, many OECD countries with private pension plans provide a preferred claim in insolvency for outstanding contributions. Canada exceeds this by providing a super-priority. Pension deficits are by and large treated as unsecured claims in OECD countries, as is the case in Canada.[87] Finally, with respect to employee benefit plans, the *United States Bankruptcy Code* provides that retiree benefit plans cannot be modified or terminated in a restructuring proceeding without court approval.[88]

Concerns haved been expressed by some stakeholders, however, that any enhancement in the existing super-priority or preferred claims could result in lenders reducing credit available to employers and change behaviour of unsecured creditors, such as suppliers who may impose more restrictive trade credit practices (e.g. shorter payment terms). Industry Canada understands that some manufacturers experienced a reduction in credit availability in 2008, when the $2,000 super-priority was first introduced. Any increase in the amount of the priorities could be anticipated to further negatively impact on credit availability, particularly for small and medium-sized enterprises which have fewer assets against which to apply the super-priority. The House of Commons Standing Committee on Industry, Science and Technology considered Bill C-501 that proposed prioritizing pension claims. The Committee heard from numerous witnesses and decided to oppose the Bill's pension-related provisions due to concerns about their potential negative impact on the Canadian economy.

> *Stakeholders are invited to make submissions regarding whether, and how, Canada could enhance protection of employee claims in insolvency proceedings.*

Employees' Claims in Asset Sales

Under the CCAA, a plan of arrangement or compromise may not be sanctioned by a court unless it provides for the payment of unpaid wages of up to $2,000 per employee and all unremitted normal cost contributions owed to a pension plan.[89] In recent years, however, the Act has been used more often to affect a liquidation of the debtor company (see discussion of "Liquidating CCAAs" above). In these circumstances, there is no plan of arrangement or compromise. In order to ensure that the asset sales that occur in a liquidation scenario do not defeat the requirement that these claims be paid, the Act provides safeguards.[90] As noted above at "Asset Sales", however, not all sales are conducted under the safeguard provisions, and for those that are it may be difficult to determine if they satisfy the safeguard provisions.

> *Stakeholders are invited to make submissions regarding whether the existing provisions adequately protect the employees' claims.*

Hardship Funds

The BIA permits the payment of interim dividends.[91] The CCAA, on the other hand, is silent on the matter. Courts have exercised their discretion to order interim distributions to vulnerable creditors in certain CCAA cases, however, it is done on a case-by-case basis.

> *Stakeholders are invited to make submissions regarding whether express authorization for interim dividends in certain circumstances is required and, if so, any potential limitations on the courts' discretion.*

Third Party Releases

A "third party release" refers to the discharge of a claim or claims against someone other than the debtor, or a director of a debtor, as part of an insolvency proceeding. The Acts are silent regarding such releases but courts have exercised their discretion "to compel the implementation of a release of the claims against third parties as part of the compromise."[92]

According to the Sarra Report, the criteria for permitting a third party release include: (1) there are special circumstances warranting the release; (2) the release is reasonably connected to the restructuring; (3) the third parties are essential to the restructuring; (4) the arrangement cannot succeed without the releases; (5) the third parties are offering a tangible, realistic contribution to the arrangement; (6) creditors generally must benefit from the arrangement; (7) creditors approve of the plan knowing the nature and effect of the releases; and, (8) the releases are fair and reasonable (*i.e.* not overly broad or offensive to public policy).[93]

> *Stakeholders are invited to make submissions regarding whether third party releases are appropriate and, if so, whether the identified criteria are sufficient to prevent potential abuse.*

Key Employee Retention Bonuses

The CCAA is silent regarding the payment of employee retention bonuses during insolvency proceedings but courts have exercised their discretion to approve bonuses on a case-by-case basis.

The payment of bonuses may be merited in some circumstances, for example, where the employees' contributions during the course of the insolvency proceedings serve to produce beneficial results for stakeholders such as encouraging restructuring, retaining valuable employees, and increasing asset recovery for creditors. On the other hand, it may be perceived as inequitable should certain employees – particularly executives and management – receive bonuses while other employees are dismissed and/or do not receive full compensation for their unpaid wages, severance and termination or pension benefits.

The Sarra Report noted concerns that bonus programs created early in a CCAA proceeding may not be properly monitored or evaluated.[94] It also suggested that some practitioners have concerns that managers may be improperly proposing such programs to benefit from their "information capital".[95]

The *United States Bankruptcy Code*[96] permits the payment of bonuses if the bonus plan was in place prior to the commencement of insolvency proceedings, the employee has an alternative employment offer, he or she is required for the restructuring and the bonus would have the effect of retaining that employee.

> *Stakeholders are invited to make submissions regarding whether employee bonuses should be permitted in an insolvency proceeding and, if so, whether terms and conditions should be codified.*
>
> *Stakeholders are also invited to make submissions regarding whether director and officer liability could be imposed for bonus programs created during an insolvency proceeding.*

Oppression Remedy

Corporate statutes provide for an 'oppression remedy' to protect complainants from oppressive conduct by a corporation or its directors.[97] Some stakeholders have suggested that in insolvency scenarios the oppression remedy is sometimes used for improper purposes, such as venue shopping or to skew negotiations, and therefore there needs to be clearer direction as to when the remedy is available in an insolvency context.[98]

> *Stakeholders are invited to make submissions regarding whether restrictions on the availability of the oppression remedy should be imposed in the insolvency context.*

Interest Claims

Stakeholders have raised concerns about the treatment of interest claims in insolvency proceedings. Although some guidance may be taken from the treatment of post-filing interest claims in bankruptcy, no clear rule exists for the treatment of such claims in CCAA proceedings.[99]

Stakeholders have suggested that interest stop accruing upon the commencement of insolvency proceedings (e.g. CCAA proceedings) in the event there is a subsequent bankruptcy. It has also been suggested that it be consistent across all insolvency legislation that no creditor be entitled to recovery post-filing interest unless all other creditors have received full payment on their claims. Finally, it has been suggested that the applicable interest rate should be the prime rate proclaimed by the Bank of Canada on the commencement of insolvency proceedings.

> *Stakeholders are invited to make submissions regarding the existing rules regarding interest claims.*

Unpaid Suppliers

The BIA provides a supplier of goods with the right to repossess those goods, subject to certain conditions.[100] In the 2008-2009 reforms, the provision was amended to provide suppliers a longer period in which to make their claim to repossess goods. The provision remains contentious, however, because the conditions have been strictly interpreted by the courts, making it difficult to use this remedy successfully.

The *United States Bankruptcy Code* grants suppliers a repossession right[101] or an administrative priority for goods delivered in the 20 days prior to commencement of insolvency proceedings.[102]

Stakeholders have suggested that s. 81.1 of the BIA be repealed as it runs contrary to the general rule that unsecured stakeholders be treated similarly. However, other stakeholders view the provision as the only protection for suppliers.

> *Stakeholders are invited to make submissions regarding the treatment of supplier claims for goods delivered in the period immediately prior to insolvency proceedings.*

Fruit and Vegetable Suppliers

On February 4, 2011, the Canada-United States Regulatory Cooperation Council (RCC) was created to better align the two countries' regulatory approaches, where possible. The RCC Joint Action Plan included a commitment to "develop comparable approaches to financial risk mitigation tools to protect Canadian and U.S. fruit and vegetable suppliers from buyers that default on their payment obligations."

In the United States, the *Perishable Agricultural Commodities Act* creates a number of financial risk mitigation tools specific to the fruit and vegetable marketplace, including information services, arbitration, temporary restraining orders and a statutory trust over the debtor's assets that were obtained from trading in produce. The statutory trust is available to any participant in the market, including farmers, packers, dealers, and wholesalers.

The BIA provides that farmers in Canada, fishers and aquaculturalists are entitled to a super-priority over all of the inventory of a bankrupt for unpaid amounts related to farming, fishing or aquaculture products delivered within 15 days of a bankruptcy or the appointment of a receiver.[103]

Under the RCC auspices, efforts were made to find solutions that would enhance the comparability between the Canadian and U.S. systems of financial risk mitigation in the fresh produce industry. For example, market-based solutions, such as credit insurance and bonding, were studied. Many fresh produce industry participants instead advocated for a legislative solution so that fresh produce claims would be paid ahead of most other creditors, including secured creditors (i.e. a super-priority). The proposed super-priority was to be paid out of any property of the bankrupt that was obtained from trading in fresh produce.

Industry Canada is interested in stakeholder views regarding the existing super-priority, including potentially expanding it to benefit U.S.-based fresh produce farmers and extending the delivery period from 15 days to 30 days, which is more consistent with practices in the marketplace.

> *Stakeholders are invited to make submissions regarding the existing farmers' super-priority in section 81.2 of the BIA.*

Deterring Fraud and Abuse

Director Disqualification

Given their key role in corporate governance, misconduct by directors both before and during insolvency proceedings attracts considerable attention. Various statutory restrictions and obligations are placed on directors to prevent, reduce and remedy misconduct (e.g. corporate, tax, environmental and employment legislation). Further, insolvency law imposes liability on directors for repayment of corporate dividends paid before bankruptcy.[104] In corporate restructuring proceedings, their misconduct or negligence is not covered by the protective indemnification charge,[105] claims against them personally for wrongful conduct may survive,[106] and they can be removed from their positions if they are unreasonably impairing or acting inappropriately with respect to the proceeding, or are likely to do so.[107] The concern about directors using 'quick flips' to strip a company of valuable assets is addressed by mandated court scrutiny of purchases of corporate assets by directors.[108] Finally, if a corporation commits a bankruptcy offence – for example failing to comply with its duties as a bankrupt[109] – a director may be fined or jailed.[110]

However, directors are not disqualified from being a director of, or from incorporating another business, even if guilty of misconduct. The issue has been addressed in various reports, articles and proposed bills, but a disqualification regime has never become law in Canada.[111] This is in contrast with the United Kingdom, where a detailed disqualification regime is in place.[112]

The concept of a disqualification regime raises interesting questions regarding the need for and efficacy of such a regime. Important issues regarding the manner of implementing, the costs of implementing and maintaining, its constitutionality, and the impact on both directors' decision making and retention both before and during an insolvency proceeding must be considered.

> *Stakeholders are invited to make submissions regarding whether directors of a corporation that has become subject to insolvency proceedings should be disqualified from acting as a director due to misconduct.*

Related Party Subordination and Set-Off

Stakeholders have suggested that the legislation be amended to allow debts among related parties to be subordinated, particularly with respect to those parties from the same corporate group. Similarly, stakeholders have suggested that the legislation be amended to prohibit set-off of debts among related parties.

> *Stakeholders are invited to provide input as to whether debts of related parties should be allowed to be subordinated, and whether set-off among related parties should be expressly prohibited.*

Cross-Border Insolvencies

Foreign Claims under "Long-Arm" Legislation

Foreign jurisdictions, including the United States and the United Kingdom, have implemented legislation that imposes liabilities on corporate group members for the pension deficits of companies located within those jurisdictions.[113] This long-arm pension legislation has the potential to put the assets of Canadian corporations at risk if an associated corporate entity cannot meet its pension obligations in that foreign jurisdiction.

In order to protect the assets of Canadian corporations from long-arm pension legislation, some stakeholders have suggested amending Canadian insolvency legislation to provide that claims from foreign long-arm legislation, unless based on claims in Canada, are not enforceable in Canada.[114]

Alternatively, stakeholders have suggested that Canada should adopt long-arm legislation similar to that in the United States and the United Kingdom that would allow Canadian creditors to pursue the assets of corporate group members in foreign jurisdictions.[115]

> *Submissions are invited regarding an appropriate response to long-arm legislation.*

Set-Off for Claims in Multiple Jurisdictions

The BIA and CCAA contain provisions regarding cross-border insolvencies that state that payments made to creditors in foreign proceedings must be taken into account by the Canadian court in determining the payment that may be made in the Canadian proceeding.[116] Some stakeholders have suggested these provisions should be more prescriptive. In situations where a creditor has claims in multiple jurisdictions for the same debt, and that creditor has successfully recovered amounts for post-filing interest in the foreign jurisdiction, such amounts should be deducted from amounts owing on account of principal from the Canadian estate.

> *Stakeholders are invited to make submissions regarding the set-off of interest claims from another jurisdiction against principal.*

Allocation of Proceeds

It has been suggested that insolvency professionals face a myriad of challenges where assets and creditors of an insolvent entity are located in multiple jurisdictions. Stakeholders have recommended that Canadian insolvency legislation be clarified in order to provide insolvency professionals with guidance as to how to access and convey assets in cross-border insolvencies, as well as to clarify how to equitably allocate the liquidated value of assets among interested parties and jurisdictions.[117]

> *Submissions are invited regarding access to, and conveyance and allocation of, assets in cross-border insolvencies.*

Treatment of Enterprise Groups

Stakeholders have raised concerns that the current insolvency legislation does not sufficiently address enterprise groups. The result is that the processes and procedures undertaken during the course of an insolvency proceeding may be driven by the most sophisticated parties.[118] The United Nations Commission on International Trade Law (UNCITRAL) has made recommendations regarding the treatment of enterprise groups in insolvency.[119] Stakeholders have suggested that Canadian insolvency legislation build on the work of UNCITRAL.

> *Stakeholders are invited to provide input regarding the treatment of enterprise groups in insolvency.*

"Centre of Main Interests"

Concerns have been raised that Canadian courts have been quick to recognize foreign jurisdictions, particularly the United States, as a debtor's centre of main interest (COMI). This may have the effect of reducing the ability of smaller creditors from effectively participating in the proceeding.[120]

Some stakeholders have suggested that Canadian courts should ensure that Canadian creditors have been given sufficient notice, disclosure and the opportunity to make submissions where an application has been made to recognize a U.S. or other foreign jurisdiction as the COMI of a Canadian debtor.[121]

> *Stakeholders are invited to make submissions regarding the need for procedural protections in cross-border recognition matters.*

Unsecured Creditors' Committees

Canadian insolvency legislation is silent regarding unsecured creditors' committees (UCCs). Nonetheless, UCCs from the United States are increasingly using cross-border protocols to gain standing in Canadian insolvency proceedings leading to increased costs for Canadian creditors who find themselves before the court on a greater number of motions and contested positions.[122]

Stakeholders have suggested that the courts should be authorized to limit the participation of UCCs in Canadian insolvency proceedings. This may be accomplished by developing principles and criteria for the recognition of a UCC and by defining the scope of participation of a UCC in order to ensure better alignment with the objectives of Canadian insolvency legislation.[123]

> *Stakeholders are invited to provide input as to whether it is appropriate to develop principles and criteria for the recognition of foreign UCCs and to define the scope of UCC participation in Canadian insolvency proceedings.*

Administrative Issues

Renaming the *Bankruptcy and Insolvency Act*

Some stakeholders have expressed concern that the term "bankruptcy" in the title of the legislation and for "trustee in bankruptcy" may create an unintended social stigma that may prevent some Canadians from seeking much needed professional assistance to obtain debt relief. As a result, these debtors may suffer greater economic and social consequences than would otherwise be the case. It has been suggested that the term "bankruptcy" be removed from use.

> *Stakeholders are invited to make submissions regarding the potential social stigma associated with "bankruptcy" and whether Canadians may be better served if that term is downplayed in the legislation.*

A Unified Insolvency Law

The federal government has constitutional jurisdiction over bankruptcy and insolvency, and has exercised this mandate through several statutes targeting different entities:

- The BIA governs liquidations and proposals for individuals and businesses;
- The CCAA applies to corporations with debts exceeding $5 million;
- The *Winding-up and Restructuring Act* (WURA) applies to financial institutions as well as certain corporations;
- The *Canada Transportation Act* (CTA) contains provisions relating to insolvent railroads.

This fragmented approach has led to criticism that it creates uncertainty for both debtors and creditors, and that a merger of some or all of the statutes or relevant provisions into one comprehensive insolvency Act could increase transparency, fairness, consistency and efficiency. Others have noted that the separate insolvency statutes provide debtors and creditors with additional flexibility to achieve a successful solution to an insolvency.

Merger of the BIA and CCAA

It has been suggested that the BIA and CCAA could be merged into a single Act, similar to the *United States Bankruptcy Code* that contains various insolvency proceedings under a single statute. This would reduce the potential for "statute-shopping". It has been stressed, however, that the flexibility of the CCAA should be maintained in such a case.

Winding-up and Restructuring Act

WURA is the primary insolvency statute available for financial institutions. It applies, however, to some non-financial enterprises as well.[124] Part I of WURA, which provides the general insolvency regime, is under the mandate of the Minister of Industry. It has not been modernized recently and stakeholders have expressed concerns that it contains a large number of outdated provisions. Parts II and III, which provide specialized rules relating to insurance companies, are under the mandate of the Minister of Finance.

There are at least two options available for dealing with WURA. First, WURA could be amended to apply only to financial institutions. In such an event, the criticisms relating to uncertainty would be addressed as all non-financial corporations would be limited to the BIA or CCAA. The stakeholder concerns regarding Part I would remain. Alternatively, WURA could be merged into a unified insolvency Act while maintaining the specialized rules relating to insurance companies.

Canada Transportation Act

The CTA includes provisions for schemes of arrangements to be made by insolvent railway companies.[125] Neither the BIA nor the CCAA apply to "railway companies".[126]

Courts have, however, permitted companies that operate a railway to commence insolvency proceedings under the BIA and the CCAA.[127] The courts have, for example, differentiated between a company, incorporated under ordinary corporate legislation, that happens to operate a railway and a company incorporated specifically for the purpose of carrying on a railway.

It has been suggested that the policy rationales for a separate, railway companies legislative regime under the CTA should be re-examined.

> *Stakeholders are invited to make submissions regarding a unified insolvency statute.*

Restricting Consumer Proposals

The BIA provides for proposals to be made by consumer debtors.[128] In 2009, the debt threshold for consumer proposals was increased from $75,000 to $250,000, excluding any debts secured by the individual's principal residence. Stakeholders have raised the concern that, with this increase, it is more likely that business debt will be captured under consumer proposals. It has been proposed that the consumer proposal provisions be further restricted to ensure that business debt is dealt with under Division I proposals.

> *Submissions are invited as to whether the consumer proposal process should be amended to ensure that it is not used with respect to business debt.*

Special Purpose Entities

Special purpose entities (e.g. corporations, limited partnerships, trusts) are used by corporations for specific, limited business purposes. For example, assets could be transferred to a special purpose entity to achieve a particular objective while insulating the parent corporation from risk. If the special purpose entity is created as a corporation or partnership, it could qualify to commence proceedings under the BIA and CCAA. Neither the BIA nor the CCAA, however, apply to a special purpose entity created as a trust

It has been suggested that trusts operating as special purpose entities should qualify for relief under the BIA and CCAA. There may, however, be issues with defining what constitutes a special purpose entity and the proposed change may trigger other consequences.

> *Stakeholders are invited to provide input on whether to expand the application of the BIA and CCAA to trusts used as special purpose entities.*

Receiverships

Codification of Receiverships

Part XI of the BIA allows a court to appoint a receiver with the power to act nationally over all, or substantially all, of the property of an insolvent person or bankrupt. Although stakeholders have suggested that receiverships are generally an effective tool in insolvency proceedings, further codification of the rules relating to receivers appointed under insolvency legislation may improve the receivership process.[129]

Other stakeholders have suggested that standardization of the rules regarding the authority of a receiver to act under the BIA, CCAA and provincial receivership legislation, including the creation of a standard set of appointment and engagement letters for receivers, would provide greater clarity and certainty in the insolvency process.[130]

> *Stakeholders are invited to provide input as to whether it is appropriate to amend the insolvency legislation to clarify the role and authority of a receiver appointed under s. 243 of the BIA; and whether it is appropriate to standardize a set of rules regarding the authority of a receiver to act across all insolvency statutes.*

No Action against Receivers without Leave of Court

Some stakeholders have suggested that the reduction in the authority of interim receivers that resulted from the 2009 legislative amendments has led to an increase in the number of receivers appointed under s. 243 of the BIA. As such, these receivers face increased liability and therefore actions against them should not be allowed without leave of the court under s. 215 of the BIA.

> *Stakeholders are invited to provide input as to whether it is appropriate to amend the insolvency legislation to require leave of the court before taking any action against a receiver.*

Marshalling of Charges

The doctrine of marshalling is an equitable concept that allows courts to arrange the assets of a debtor to ensure that all creditors are paid to the greatest extent possible. For example, where a senior creditor has recourse to two or more assets from which to satisfy its debt, and a junior creditor has access to only one asset, the senior creditor would be required to satisfy its debt first out of the asset in which the junior creditor has no interest.

The BIA does not currently include the concept of marshalling. It has been suggested that it may be beneficial if the Act expressly provided for marshalling of charges to ensure greater fairness and efficiency.

> *Stakeholders are invited to provide input as to whether it would be appropriate to amend the insolvency legislation to codify the doctrine of marshalling charges.*

Tax Issues

The following tax-related issues have been raised by stakeholders in the insolvency context. The issues are included to solicit information regarding the nature of concerns and the extent to which such issues potentially affect insolvency proceedings:

- Whether a restructured tax debtor with prior tax obligations should be allowed "fresh start accounting" for tax purposes – specifically those resulting from debt forgiveness – being dealt with as "pre-filing claims";
- Whether tax authorities should be required to send a notice in accordance with section 244 of the BIA before issuing enhanced requirements to pay;
- Whether account receivables that are the object of pre-filing enhanced requirements to pay should "re-vest" in the estate; and
- Whether debt forgiveness rules should apply in consumer proposals.

Technical Issues

Bankruptcy and Insolvency Act

Section 197 - Costs Against the Debtor

Sometimes the conduct of the debtor with respect to his or her discharge hearing creates unnecessary expenses for the trustee or creditors. Stakeholders have suggested that one remedy for this could be granting the court the explicit authority to order costs against the debtor in the appropriate circumstances.

> *Submissions are invited as to whether subsection 197(6.1) should be amended to permit costs to be awarded against the debtor.*

Section 204.3 – Losses Due to Bankruptcy Offences

Section 204.3 provides a mechanism for persons convicted of an offence under the BIA to provide compensation for the loss they have caused, but only where that loss is as a result of damage to property. Stakeholders have suggested that this be extended to all losses, not just those relating to damage to property.

> *Submissions are invited as to whether s.204.3 should be broadened to capture all losses resulting from the BIA offence.*

Disallowance of Claims

One of the roles of a trustee is to assess creditor claims. If the claim cannot be supported, the trustee will disallow it. The impact is that the creditor may no longer participate in the BIA process and will receive no dividend out of the estate. This may be a significant impact on the creditor. The existing provision permits 30 days to appeal a disallowance or to seek an extension of the 30-day period.[131] Stakeholders have suggested that the court be granted the authority to permit an appeal beyond the 30-day period in appropriate circumstances.

> *Submissions are invited as to whether it is appropriate to provide the court with the authority to extend the period for appealing the disallowance of a claim.*

Securities Firms Bankruptcies

Part XII of the BIA provides a streamlined procedural framework for the administration of the bankruptcies of securities firms. Stakeholders have noted that Part XII does not empower securities regulators or customer compensation bodies to petition insolvent securities firms into bankruptcy, and have called for BIA amendments to provide for this power and clarify the conditions under which it may be exercised.

> *Submissions are invited as to whether securities regulators or customer compensation bodies should be able to apply for a bankruptcy order.*

Preview of Proposals by the Trustee

There have been anecdotal reports that proposal trustees, after having accepted an engagement, discover that the debtor's financial situation is worse than expected. It has been suggested that a trustee should have the right to examine the size and complexity of a BIA proposal file before accepting an engagement.[132]

> *Submissions are invited as to whether proposal trustees should be provided with a mechanism to preview the size and complexity of a BIA proposal file before they accept it.*

Section 173 - Facts for Which Discharge Will be Suspended

Section 173(1) of the BIA sets out a list of facts for which the discharge of the bankrupt may be refused, suspended, or granted conditionally by the court. Some stakeholders have questioned whether the list of facts is out of date and needs to be updated.

> *Stakeholders are invited to make submissions regarding whether the list of facts for which a bankrupt's discharge will be refused, suspended or granted conditionally needs to be updated.*

Treatment of RRSPs in Bankruptcy

In 2008, the BIA was amended to exempt registered retirement savings plans (RRSPs) from seizure in bankruptcy, subject to a clawback of contributions made in the 12 months immediately prior to a bankruptcy.[133] Some stakeholders criticized the measure because it creates a potential for abuse since a bankrupt may put funds into the RRSP prior to a bankruptcy and then have access to the funds immediately following their discharge for non-retirement purposes.

Stakeholders have suggested that a lock-in mechanism, which would require the bankrupt to keep the funds in the RRSP until retirement, would fulfill the policy intent of the measure.

> *Stakeholders are invited to make submissions regarding the treatment of RRSPs in bankruptcy and potential mechanisms to protect the integrity of the insolvency regime.*

Secured Creditors Calling Proposal Meetings

The administrator of a consumer proposal must call a meeting of creditors in two circumstances: (1) where directed to do so by the official receiver or (2) where, at the expiration of the 45-day period following the filing of the consumer proposal, creditors having in the aggregate at least 25 percent in value of the proven claims have requested a meeting.[134] If neither of these circumstances arises the administrator is not obliged to call a meeting of creditors and the consumer proposal is deemed to be accepted by the creditors.[135]

In situations where the claims of unsecured creditors do not amount to at least 25 percent in value of the proven claims, the unsecured creditors would not be able to ensure that a meeting of creditors is called. As such, some stakeholders have advised that whether the consumer proposal is accepted or not in these situations can be controlled by secured creditors who may have little or no economic interest in the outcome of the proposal since they maintain their right to realize their security.

> *Stakeholders are invited to make submissions regarding the basis upon which a meeting of creditors may be called in the case of a consumer proposal.*

Footnotes

[1] *Husky Oil Operations Ltd. v. Minister of National Revenue*, 1995 CanLII 69 (SCC), [1995] 3 SCR 453, at paragraph 7.

[2] *Schreyer v. Schreyer*, 2011 SCC 35 (CanLII), [2011] 2 SCR 605.

[3] R.J. Wood, *Bankruptcy and Insolvency Law* (Toronto: Irwin Law Book, 2009) at page 4 (referring to UNCITRAL Legislative Guide on Insolvency Law at page 14).

[4] Allan Crawford and Umar Faruqui, "What Explains Trends in Household Debt in Canada?" in *Bank of Canada Review* (Winter 2011) find that the aggregate debt-to-income ratio of Canadian households has trended upward over the past 30 years utilizing data collected from Ipso Reid's *Canadian Financial Monitor*. This trend has been documented by a 2011 TD Bank study "Assessing the Financial Vulnerability of Households Across Canadian Regions" and by Statistics Canada.

[5] Bailliu *et al*. "Household Borrowing and Spending in Canada," in *Bank of Canada Review* (Winter 2011) find that the sizable increase in the ratio of household debt to income in Canada over the past decade has coincided with a period of sustained strong growth in house prices. They conclude that the main driver of the rise in household debt has been home-equity extraction—household borrowing against equity in existing homes through increases in mortgage debt and draws on home-equity lines of credit. The authors speculate that home equity may serve as a substitute for other types of consumer debt.

[6] Source: The Office of the Superintendent of Bankruptcy. The consumer insolvency rate is defined as the number of consumer insolvencies per one thousand residents aged 18 years or above. The business insolvency rate is defined as the number of business insolvencies per one thousand businesses.

[7] In recent years, economists and social scientists have found that the transition to adulthood is taking longer to complete. For example, using Statistics Canada survey data, Clarke (2007) finds that in "the transition to adulthood is now delayed and elongated. It takes today's young adults longer to achieve their independence: they are leaving school later, staying longer in their parents' home, entering the labour market later, and postponing conjugal unions and childbearing" (pp. 14). It is important to note that the implications of this trend for the financial situations of older cohorts and for insolvency trends have not been demonstrated conclusively. Clark, Warren. "Delayed transitions of young adults." *Canadian Social Trends 84 (2007)*: 14-22.

[8] David Fieldhouse, Igor Livshits and James MacGee (2012), "Income Loss and Bankruptcies over the Business Cycle." Office of the Superintendent of Bankruptcy. The authors investigate factors that drive cyclical fluctuations in consumer insolvency filings, using an aggregate analysis using historical data at the national, provincial and city levels, and micro-level analysis which makes use of a unique dataset of Canadian filers.

[9] In 2012, the GDP growth rate among the Atlantic Provinces ranged from negative to low (4.4 percent in Newfoundland and Labrador, to -1.1 percent in New Brunswick, and -0.1 percent in Nova Scotia), while Alberta (3.8 percent), Manitoba (2.6 percent) and Saskatchewan (1.9 percent) saw the highest levels of economic growth.

[10] According to Statistics Canada, in 2012, Canada's unemployment rate was 7.2 percent. Newfoundland and Labrador had the highest unemployment rate in the country at 12.5 percent. Prince Edward Island and New Brunswick had the second and third highest unemployment rates at 11.3 percent and 10.2 percent, respectively. Alberta (4.6 percent) and Saskatchewan (4.7 percent) had the lowest unemployment rates. See Provincial and Territorial Economic Accounts, 2012 (Accessed on January 10, 2014).

[11] Provincial exemption regimes are respected in the BIA, permitting bankrupts to keep certain property as set out in provincial legislation (e.g., work tools, a vehicle, personal belongings).

[12] Section 178(1) of the BIA contains a list of debts that are not released upon discharge. Corporate bankrupts do not receive a discharge unless all debts are paid in full.

[13] Section 168.1 of the BIA.

[14] Standing Senate Committee on Banking, Trade and Commerce, 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the* Bankruptcy and Insolvency Act *and the* Companies' Creditors Arrangement Act.

[15] Classes of non-releasable debts include fines or penalties related to criminal or quasi-criminal offences, debts owed in respect of fraud, embezzlement or misappropriation of funds, and alimony or family support orders. See BIA s.178(1) for the full list.

[16] For example, see *Simone* v. *Daley*, 1999 CanLII 3208 (ON CA).

[17] For a review of the issues raised by these regimes, see: "Section 270 of the *Highway Traffic Act*," Manitoba Law Reform Commission, 1997.

[18] E.g., *Traffic Safety Act*, R.S.A. 2000, C. T-6, ss 102(1); *Highway Traffic Act*, R.S.O. 1990, c. H.8, ss.198(1); *Highway 407 Act*, 1998, S.O. 1998, c.28, s.22.

[19] *Bankruptcy Code,* 11 U.S.C. §525(a).

[20] For example, see *Canada (Superintendent of Bankruptcy)* v. *407 ETR Concession Company Limited*, 2013 ONCA 769; *Gorguis* v. *Saskatchewan Government Insurance*, 2011 SKQB 132, *Moloney* v. *Alberta (Administrator, Motor Vehicle Accident Claims Act)*, 2012 ABQB 644, and *Ontario (Finance)* v. *Clarke and Superintendent of Insurance for Ontario,* 2013 ONSC 1920.

[21] Personal Insolvency Task Force: Final Report (2002).

[22] Senate Report, *supra* note 22.

[23] Janis Sarra and Susan B. Boyd, "Competing Notions of Fairness: A Principled Approach to the Intersection of Insolvency Law and Family Property Law in Canada," in J. Sarra ed., *Annual Review of Insolvency Law* 2011 (2012), 207 at 208 – citing a study that marital breakup accounts for approximately 10 percent of individual bankruptcies each year.

[24] Section 136(1)(d.1) of the BIA.

[25] Section 178(1)(b) and (c) of the BIA.

[26] *Schreyer* v. *Schreyer*, 2011 SCC 35.

[27] In the case, the non-bankrupt spouse successfully had the bankrupt spouse's discharge annulled and she received payment from the exempt assets.

[28] BIA ss.60(4), 66.26(3) and s.147.

[29] In summary administration bankruptcies, the levy is capped at $200 in accordance with Rule 123(3) of the BIA General Rules.

[30] BIA ss. 121(4).

[31] BIA paragraph 136(1)(d.1).

[32] BIA paragraphs 178(1)(b) and (c).

[33] *Re Cameron* 2003 CarswellAlta 624 (Alberta Court of Appeal).

[34] Senate Report, *supra* note 22 at p. 86.

[35] Senate Report, *supra* note 22 at p. 84.

[36] *Ibid*., at p. 52.

[37] Repayment Assistance.

[38] Section 178(1.1) of the BIA.

[39] Dr. Janis Sarra is the Director of the Peter Wall Institute for Advanced Studies and Professor of Law, Faculty of Law, University of British Columbia.

[40] Examining the Insolvency Toolkit: Report of the Public Meetings on the Canadian Commercial Insolvency Law System.

[41] BIA section 82 permits a patent holder the right to repurchase patented goods from a trustee for the original invoice price, less any depreciation.

[42] BIA section 83 provides limited protection to copyright authors.

[43] Sarra Report at p. 23.

[44] Sarra Report at p. 12.

[45] Insolvency Institute of Canada, Report of the Task Force on Derivatives (Nov. 2013).

[46] Sarra Report at pp. 58-60.

[47] *Ibid*.

[48] U.S. Department of Justice, Appendix B: Guidelines for Reviewing Applications for Compensation and Reimbursement of Expenses Filed under United States Code by Attorneys in Larger Chapter 11 Cases. *Federal Register*, Vol. 78, No. 116, June 17, 2013.

[49] See Elaine Kempson, "*Review of Insolvency Practitioner Fees Report to the Insolvency Service*," July 2013.

[50] See "*Proposal paper: A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia*," Australian Government, December 2011.

[51] Section 23(1)(a)(ii)(C) of the CCAA.

[52] Sarra Report, p.13.

[53] CCAA s.11.7.

[54] Sarra Report, p. 73.

[55] CCAA s.23-25.

[56] CCAA s.25 and 28 to 31.

[57] Sarra Report, p. 74.

[58] Sarra Report, p. 76.

[59] E.g., CCAA s.25.

[60] CCAA subparagraph 11.7(2)(a)(iii).

[61] CCAA sections 11.7, and 28 – 30.

[62] *Re White Birch Paper Holding Co.*, 2010 CarswellQue 1780 (Que. S.C.J.); *Re Canwest Global Communications Corp.* (2009), 2009 CarswellOnt 6184 (Ont. S.C.J. [Commercial List]).

[63] *United States Bankruptcy Code*, 363 k.

[64] Sarra Report, p. 26.

[65] Sarra Report, p. 32.

[66] Sarra Report, pp. 31-32.

[67] CCAA s.36.

[68] BIA s.65.13(8); CCAA s.36(7).

[69] CBCA s.192.

[70] Sarra Report, p. 69.

[71] Policy Concerning Arrangements Under Section 192 of the CBCA.

[72] CBCA subsection 192(4).

[73] Sarra Report, p. 71.

[74] Sarra Report, p. 115.

[75] Subsection 50.4(9) of the BIA.

[76] Sarra Report, page 112.

[77] Sarra Report, page 123.

[78] Sarra Report, page 16.

[79] BIA, s.81.3 and s.81.4.

[80] E.g. section 81.3(3).

[81] BIA, s.136(1)(d).

[82] BIA, s.81.5 and s.81.6.

[83] BIA, s.60(1.3); CCAA, s.6(5)(a)(i).

[84] BIA, s.60(1.3); CCAA, s.6(5)(a)(ii).

[85] BIA, s.60(1.5); CCAA, s.6(6).

[86] Departmental researchers relied significantly on "Employee and Pension Claims During Company

Insolvency: A Comparative Study of 62 Jurisdictions," by Dr. Janis Sarra, June 2008.

[87] Many OECD countries, including the United States, the United Kingdom and Germany, provide pension benefit guarantee funds that will pay pensions (capped) in the event the employer is not able to do so. Ontario is the only jurisdiction in Canada that offers a pension benefits guarantee fund.

[88] Section 1114 sets out detailed requirements that must be met prior to the court being permitted to modify or terminate such plans.

[89] CCAA ss.6(5) and (6); See also BIA 60(1.3) and (1.5).

[90] CCAA ss.36(7); See also BIA ss.65.13(8).

[91] BIA ss.136(2) and ss.148(1).

[92] Sarra Report, p. 90.

[93] Sarra Report, p. 92.

[94] Sarra Report, p. 105.

[95] Sarra Report, p. 105-106.

[96] *Bankruptcy Code* 11 USC §503(c).

[97] E.g. CBCA s.241.

[98] Sarra Report, p. 108.

[99] Carfagnini, J.A. and C. Costa, *Claims for Post-Filing Interest and Prepayment Premiums in a CCAA Proceeding*, Annual Review of Insolvency Law 2011 (J. Sarra, Editor)

[100] BIA section 81.1.

[101] USBC section 546(c)(1).

[102] USBC section 503(b)(9).

[103] BIA section 81.2.

[104] BIA s.101.

[105] BIA ss.64.1(4); CCAA ss.11.51(4)

[106] BIA ss.50(14) and (15); CCAA ss.5.1(2) and (3)

[107] BIA s.64; CCAA s.11.5.

[108] BIA ss.30(4), ss.30(5), ss.65.1(5), ss.65.1(6); CCAA ss.36(4), ss.36(5)

[109] BIA ss.198.

[110] BIA s.204.

[111] Tasse Report; Bill C-60 (1975); Bill C-17 (1976); Colter Committee; Girgis, Jasmine, "Corporate Directors' Disqualification: The New Canadian Regime?" (2009) Alberta Law Review 46:3.

[112] *Company Directors Disqualification Act 1986* (U.K.), 1986, c. 46.

[113] Sarra Report, pp. 40, 42.

[114] Sarra Report, p. 42.

[115] Sarra Report, p. 45.

[116] BIA s. 283; CCAA s. 60.

[117] Sarra Report, p. 23.

[118] Sarra Report, p. 48.

[119] UNCITRAL Legislative Guide on Insolvency Law—Part three: Treatment of enterprise groups in insolvency.

[120] Sarra Report, p. 47.

[121] Sarra Report, p. 51.

[122] Sarra Report, p. 50.

[123] Sarra Report, p. 51.

[124] See section 6, WURA, R.S.C., 1985, c. W-11.

[125] CTA sections 106-110.

[126] BIA section 2, definition of "corporation"; CCAA section 2(1), definition of "company."

[127] Cases in which the courts have accepted the filing involving a "railway" include: Quebec Southern Railway Co. (2001), Quebec C.A. 500-11-017184-017, Kelowna Pacific Railway Ltd. (2013), and Montreal, Maine & Atlantic Canada Co. (2013).

[128] BIA s.66.12.

[129] Sarra Report, p. 132.

[130] Sarra Report, p. 132-133.

[131] BIA subsection 135(4).

[132] Sarra Report, p. 130-132.

[133] BIA subsection 67(1)(b.3).

[134] BIA section 66.15(2).

[135] BIA section 66.18.

TAB 111

CASTEL & WALKER

CANADIAN CONFLICT OF LAWS

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VOLUME 1

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CHAPTER 3

CHARACTERIZATION AND THE INCIDENTAL QUESTION

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CHAPTER 3

CHARACTERIZATION AND THE INCIDENTAL QUESTION

§3.1 THE ROLE OF CHARACTERIZATION IN CHOICE OF LAW ANALYSIS

In an action involving legally relevant foreign elements, a court might be asked to apply foreign law.[1] To decide whether to do so, the court must ascertain the legal nature of the questions or issues that require adjudication and then apply its appropriate conflict of laws rules to them. For instance, do the facts raise a question of succession or of matrimonial property, or a question of capacity or of form? This analytical process is called characterization or classification. Its purpose is to enable the court to find legal categories with which the forum is familiar.[2] In other words, the court must allocate each question or issue to the appropriate legal category. The application of the forum's conflict of laws rule to each legal question or issue will indicate which legal system governs that question or issue. That legal system is called the *lex causae*.

Once the court has characterized the issue, it will consider the connecting factor—a fact or element connecting a legal question or issue with a particular legal system. Finally, the court will apply the law identified as the governing law. In doing so it must separate the rules of substance from the rules of procedure of the legal systems involved, because questions of procedure are governed by the *lex fori*.[3]

If the fact situation includes at least one foreign place element as, for example, the domicile of a person, the place of making of a contract, or the *situs* of a thing, a problem of conflict of laws may arise. The court must decide whether it should apply its own domestic law or whether by reason of the existence of the foreign place element, it should apply rules of the law of that place, or even whether, as regards different aspects of the case, resort should be had to the various foreign laws of the places in which various elements are respectively localized.

A conflict of laws rule is usually stated in the form of an abstract proposition, such as "capacity to convey land is governed by the law of the *situs* of the land," or "the formalities of a contract are governed by the law of the place of contracting," or "succession to movables (as distinguished from administration) is governed by the law of the last domicile of the deceased person." A proposition of this kind is equivalent to saying that, as regards a particular kind of legal question or issue, a particular element (*situs*, place of contracting or domicile, as the case may be) is the one which should be used as the appropriate connecting factor, that is, the element that connects the factual situation or legal question or issue with the governing law. In a simple case, governed by a settled conflict of laws rule of the forum, the selection of the connecting factor may seem to be at best the use of a convenient mechanical device, and at worst the interjection of an unnecessary step, in the selection of the proper law. But in a doubtful or difficult case the deliberate consideration of the significance of various elements in the factual situation may assist in the analysis of the problem presented to the court, and may afford a useful approach to the selection of the proper law, involving sometimes the application by analogy of an existing conflict of laws rule or sometimes the formulation of a new conflict of laws rule appropriate to a new situation.

Logically, the selection of the connecting factor and the consequent selection of the proper law must be preceded by the *characterization of the question or issue*, followed by the application of the proper law. In substance, the enquiry proceeds in three stages:

First, the court characterizes, or defines, the juridical nature of the question or issue upon which its adjudication is required (other words are also used to describe this process, *e.g.*, qualification, classification). As mentioned above, rules of the conflict of laws are often expressed in terms of legal concepts combined with facts or elements, and the legal question or issue involved in a given factual situation must be at least provisionally determined before a particular conflict of laws rule of the forum can be used. There may even be different aspects of the factual situation giving rise to different legal questions or issues governed by different conflict of laws rules. If a provision of a given foreign law is the governing law on some characterization of the question or issue or one of the questions or issues, that provision should be characterized, in its context in the foreign law, during the process of characterizing the legal question or issue.

Second, the court should select one of the place elements as being the connecting factor appropriate to the question or issue, or to each of the questions or issues, as already characterized, and consequently select the proper law or laws to which resort should be had. For instance, if the factual situation has been characterized as raising a question of succession to movables, the court will apply its conflict of laws rule for this legal question: succession to movables is governed by the law of the last domicile of the deceased. The connecting factor, which in this case is domicile, is the place element which connects the legal question with the law of a particular place. Where was the last domicile of the deceased? The answer to this question will result in application of the law of a particular legal unit as the law governing the legal question.

Third, to answer the question, or each of the questions, the court applies the law selected for each question to the facts of the case. That is, the court applies the domestic rules of the law of the forum, or rules similar to or identical with the domestic rules of the law of the foreign legal unit as the case may be, to the factual situation as it exists, except that the place elements are hypothetically situated in the legal unit to the law of which resort is had as regards each particular question or issue.

In a variety of circumstances there may arise what may be called a conflict of conflict of laws rules, that is, a difference between the conflict of laws rules of the laws of two legal units connected with a single situation, as distinguished from a difference between the domestic rules of the laws of the two legal units.

There may be a patent conflict of conflict of laws rules resulting from the fact that the conflict of laws rules of two legal units are different in terms, because as regards the same legal question or issue they use different connecting factors. For example, a conflict of laws rule of X may say that the *lex domicilii* governs a given legal question or issue, such as succession to movables, and a conflict of laws rule of Y may say that the same question or issue is governed by the *lex patriae*, and the deceased is a national of X domiciled in Y. It is assumed of course that there is some difference between the domestic rules of the laws of X and Y which makes a choice between the two laws necessary. This raises the question of *renvoi*.

There may be an apparent conflict of conflict of laws rules resulting from the fact that the conflict of laws rules of two legal units are apparently the same in that, as regards a particular question or issue, they use nominally the same connecting factor, but that factor is defined in different ways in the two legal units. For example, such conflict occurs if the conflict of laws rules of X and Y are the same in terms in that both say that succession to movables is governed by the *lex domicilii* of the deceased at the time of his or her death, but according to the law of X the deceased was domiciled in Y (by the domestic law of which a testator has only a limited testamentary power); and according to law of Y the deceased was domiciled in X (by the law of which a testator has unlimited testamentary power). Another example is if the conflict of laws rules of X and Y are the same in terms, in that both say that the formalities of making of a contract are governed by the law of the place of making, but according to the law of X the contract was made in Y (place of posting of the acceptance) and the contract is formally valid by the law of Y, and according to the law of Y the contract was made in X (place of receipt of the acceptance) and by the law of X the contract is formally invalid.

A latent conflict of conflict of laws rules may also result from the fact that although the conflict of laws rules of two legal units appear to be identical in terms, using the same connecting factor in the same sense as regards a specified question or issue, they are in reality different because the ostensibly identical question or issue is characterized in different ways in the two legal units. For example, a person is domiciled in X when he or she makes a will and subsequently marries, and is domiciled in Y at time of his or her death. The conflict of laws rules of X and Y are identical in terms in that both say that questions or issues of succession to movables are governed by the *lex domicilii* at the time of death and questions or issues of marriage are governed by the *lex domicilii* at the time of marriage. "Revocation" of a will by the subsequent marriage of the testator is characterized in X as an issue of succession, and is therefore governed by the law of Y (which contains a provision as to the "revocation" of a will by the subsequent marriage of the testator subject to an exception which makes the provision inapplicable to the particular situation), and the same issue is characterized in Y as a question of marriage, and is therefore governed by the law of X (which contains a provision "revoking" a will by the subsequent marriage of the testator but omits the exception specified in the law of Y). The example might be varied by the supposition that one of the two laws (those of X and Y) contains no provision at all with respect of the revocation of a will by the subsequent marriage of the testator, or that one of the two laws contains a provision of this kind in addition to a provision that a will is revoked by the subsequent birth of a child of the testator.

The characterization of questions or issues is a constantly recurring phase of every case involving a legally relevant foreign element. In a jurisdiction-selecting context, questions or issues must be framed in broad terms as the forum's range of conflict of laws rules is usually quite narrow.

To characterize is to interpret a conflict of laws rule of the forum. For instance, if the rule is that succession to movables is governed by the law of the last domicile of the deceased, the court, before applying this rule, must ascertain whether the facts raise a question or issue of succession and whether movables are involved. Are the rights of subrogation in an insurance claim arising from a motor vehicle accident in another country governed by the law of the place where the accident occurred or by the law governing the contract of insurance?[4] Are the proceeds of charitable trusts subject to liquidation under a winding-up order as a matter of insolvency or a matter of trust?[5] This process of characterization is common to all legal reasoning and, it is submitted, can only be done according to the interpreter's rules of interpretation. Sometimes the characterization is easy or even obvious, but sometimes it is difficult or doubtful. In difficult cases, if on any characterization to the question or issue there may be a reference to a foreign law, Falconbridge proposed that the characterization should first be provisional, and the final characterization should be postponed until after the court has consulted the provisions, in their context, of the foreign law that may be the proper law on the final characterization of the question or issue, or any of the questions or issues, that the court has to decide. Thus the court may have to characterize the provisions of a potentially applicable foreign law. In this way the court, before finally characterizing the question or issue, will know what the consequences of its characterization will be. Falconbridge called this approach to the problem of characterization a *via media* between the characterization by the *lex fori* and characterization by the *lex causae*.[6]

The *via media* has been criticized on the ground that it seems to assume that it is the function of the court to examine foreign law of its own motion, but this is not the case in Canada and many other jurisdictions. Moreover, which final characterization should the court adopt where the legal nature of the question or issue is different depending upon whether the *lex fori* or the *lex causae* is applied? Should the court's choice be influenced by policy considerations? A variation of the *via media* method would be to characterize the legal nature of the question or issue initially by the *lex fori*. The appropriate conflict of laws rule would then be applied to the legal question or issue. If some foreign law were applicable, the legal nature of the question or issue would be characterized again, and finally, by this *lex causae*.

It has also been suggested that a distinction could be made between primary and secondary characterization: the *lex fori* should apply to primary characterization, which is the allocation of the issue to its correct legal category, and the *lex causae* to secondary-characterization, which is the delimitation and application of the proper law once selected. The connecting factor would be interpreted in accordance with the *lex fori*.

Characterization by reference to the *lex fori*, although far from perfect, appears to be the only logical and practical solution for determining the legal nature of the questions or issues, since after doing so the court must apply and interpret its own applicable conflict of laws rules.[7] Characterization by reference to the *lex causae* may not be feasible at this stage of legal reasoning as characterization of the legal nature of the questions or issues always precedes the determination of the *lex causae*. Before characterizing the legal nature of the questions or issues, it is difficult to know whether some foreign law or the *lex fori* is applicable. Furthermore, if the *lex causae* characterized any question or issue as belonging to a legal category unknown to the *lex fori* the court could not apply to it any of its conflict of laws rules.

As a general rule, the conflict of laws rules of the forum must be interpreted and applied in the light of the forum's legal concepts and categories. This does not mean that purely internal concepts or legal categories have to be used in the process of characterization. The purposes of the conflict of laws must be taken into consideration. For instance, on the international level, the domestic distinction between realty and personalty gives way to that of movables and immovables. Where the plaintiff's claim is unknown to the *lex fori*, the court, in order to apply its appropriate conflict of laws rule, will have to analyze this claim in the light of the foreign legal system on which it is based in order to determine into which broad legal categories or concepts of the *lex fori* it can be fitted. This is why paragraph two of article 3078 of the Quebec *Civil Code* provides that "[w]here a legal institution is unknown to the court or known to it under a different designation or with a different content, foreign law may be taken into account".

In other words, the legal concepts and categories of the domestic law must accommodate the nature of the claim and the rules and institutions of the foreign legal systems that might be involved. Only by giving a flexible meaning to domestic categories and concepts can the court determine the legal nature of the questions or issues in difficult cases. Otherwise, it would be impossible to characterize some types of legal relations recognized only in foreign legal systems.

Accordingly, for the purposes of the conflict of laws, characterization is a technique of interpretation that should be performed by reference to the forum's concepts and policies *as applied to conflicts situations* and not exclusively by reference to the *lex fori* applicable to purely domestic situations. However, this principle admits of one clear exception: that relating to the distinction between movable and immovable property. Canadian courts characterize property as either movable or immovable in accordance with the law of the place where the property is situated. This would appear to be a product of the deference to the exclusive jurisdiction of the courts of the place where an immovable is situated to determine title to it. If a court applied its own law and characterized property as movable, it might, as a result, assume jurisdiction over property that would be considered immovable under the law of the place where it was situated and thereby interfere with the exclusive jurisdiction of the courts of that place to determine its title. Article 3078 of the *Civil Code* of Québec provides that "Characterization is made according to the legal system of the court seised of the matter; however, characterization of property as movable or immovable is made according to the law of the place where it is situated."[8]

[1] See Chapter 11, "The Bases of Judicial Jurisdiction".

[2] In *MacMillan Inc. v. Bishopsgate Investment Trust plc (No. 3)*, [1995] 3 All E.R. 747 (Ch. D.); affd [1996] 1 All E.R. 585 (C.A.), the court remarked, at 757, that: "In order to ascertain the applicable law under English conflict of laws, it is not sufficient to characterize the nature of the *claim*; it is necessary to identify *the question at issue*." The literature on the subject is impressive. See, *e.g.*, Beckett, "The Question of Classification (Qualification) in Private International Law" (1934) 15 Brit. Y.B. Int'l. L. 46; Bland, "Classification Reclassified" (1957) 6 Int. & Comp. L.Q. 10;

Cavers, *The Choice of Law Process* (1965); Cheatham, "Internal Law Distinctions in the Conflict of Laws" (1936) 21 Cornell L.Q. 570; Cook, "Characterization in the Conflict of Laws" (1941) 51 Yale L.J. 191; Cormack, "Renvoi, Characterization, Localization, and Preliminary Question in the Conflict of Laws" (1941) 14 S. Cal. L. Rev. 221; Ehrenzweig, "Characterization in the Conflict of Laws: An Unwelcome Addition to American Doctrine," in *XXth Century Comparative and Conflicts Law* (1961) at 395; *Private International Law* (1967) at 111 *et seq.*; Falconbridge, "Conflict of Laws: Examples of Characterization" (1937) 15 Can. Bar Rev. 215; "Characterization in the Conflict of Laws" (1937) 53 L.Q. Rev. 235 at 537; "Conflict Rule and Characterization of Question" (1952) 30 Can. Bar Rev. 103 at 264; Lederman, "Classification in Private International Law" (1951) 29 Can. Bar Rev. 3 at 168; Lorenzen, "The Qualification, Classification, or Characterization Problem in the Conflict of Laws" (1944) 50 Yale L.J. 743; "The Theory of Qualifications and the Conflict of Laws" (1920) 20 Colum. L. Rev. 247; Morse, "Characterization: Shadow or Substance" (1949) 49 Colum. L. Rev. 1027; Overton, "Analysis in the Conflict of Laws: The Problem of Classification" (1951) 21 Tenn. L. Rev. 600; Pascal, "Characterization as an Approach to the Conflict of Laws" (1940) 2 La. L. Rev. 714; Rigaux, *La théorie des qualifications en droit international privé* (1956); Robertson, *Characterization in the Conflict of Laws* (1940); "A Survey of the Characterization Problem in the *Conflict of Laws*" (1939) 52 Harv. L. Rev. 747.

[3] See Chapter 6 "Substance and Procedure".

[4] *Kingsway General Insurance Co. v. Canada Life Assurance Co.*, [2001] O.J. No. 3285, 149 O.A.C. 303 (holding that the law governing the contract of insurance governed rights of subrogation under it).

[5] *British Columbia (Attorney General) v. Rowland*, [2002] B.C.J. No. 1213, 3 B.C.L.R. (4th) 284 (S.C.) (*sub nom. Rowland v. Vancouver College Ltd.*).

[6] See *Essays on the Conflict of Laws*, 2nd ed. (1954), at 53, 58-72.

[7] Note that the *Private International Law (Miscellaneous Provisions) Act 1995*, (U.K.) c. 42, states in s. 9(2): "The characterisation for the purposes of private international law of issues arising in a claim as issues relating to tort or delict is a matter for the courts of the forum." Will such characterization be by reference to the *lex fori* or to the purposes of private international law, or will it take both into account?

[8] *Minera Aquiline Argentina SA v. IMA Exploration Inc.*, [2006] B.C.J. No. 1626, 32 C.P.C. (6th) 31 (S.C.), affd [2007] B.C.J. No. 1232, 43 C.P.C. (6th) 45 (C.A.), leave to appeal to S.C.C. denied [2007] S.C.C.A. No. 424; *Air liquide Canada inc. c. Bombardier inc.*, [2010] J.Q. no 9078, J.E. 2010-1710 (C.A.), affg [2010] J.Q. no 8678, J.E. 2010-1620 (S.C.); *Bousquet c. Acer America Corp. (Canada)*, [2012] J.Q. no 1574, 2012 QCCQ 1261, [2012] R.J.Q. 555 (example of characterizing the nature of contract that was the object of the litigation); *E. Hofmann Plastics Inc. v. Tribec Metals Ltd.*, [2013] Q.J. No. 17222, 2013 QCCA 2112, J.E. 2014-15.

§3.2 EXAMPLES OF CHARACTERIZATION OF A LEGAL QUESTION OR ISSUE

The characterization of most legal issues is obvious and uncontroversial. However, sometimes the superficial simplicity disappears on closer examination. The cases that are especially challenging are those in which it is doubtful whether the question or issue is of one kind requiring the application of one conflict of laws rule or of another kind requiring the application of another conflict of laws rule, or even whether the question or issue is such that it does not come within any existing conflict of laws rule, so that, by analogy or otherwise a new conflict of laws rule is required. Among the questions or issues that might give rise to issues of characterization in the process of finding the appropriate conflict of laws rule and consequently selecting the proper law are questions or issues relating to:

[The next page is 3-7]

(a) the administration of estates of deceased persons and succession on death respectively;

(b) the capacity to marry, to make a marriage or domestic contract or settlement, to make a commercial contract, to convey property *inter vivos*, and to succeed to property on death;

(c) the existence of a status distinguished from some incident of that status or the capacity of a person having that status for any of the purposes mentioned in (b);

(d) the formal validity, distinguished from the intrinsic validity, of a marriage, a contract, a conveyance or a will;

(e) succession on death distinguished from contract or conveyance *inter vivos*, or matrimonial property or marriage law;

(f) succession to land, movables or intangibles;

(g) contractual or equitable rights relating to land and interest or property in land;[1]

(h) the distinction between matrimonial property rights and property rights;

(i) the rights and duties of parties to transactions *inter vivos* as between themselves and as regards third parties;

(j) delictual or contractual liability;

(k) the distinction between movables and immovables;

(l) substantive law and procedural law.[1.1]

In *Beaudoin v. Trudel*,[2] the Ontario Court of Appeal had to distinguish between a question of matrimonial property and a question of succession in order to decide whether to apply the law of Quebec based on the former characterization or law of Ontario based on the latter characterization. In *Re Jutras Estate*[3] the Saskatchewan Court of Appeal had to determine the nature of an irrevocable donation to the surviving consort of the whole of the property belonging to the deceased at the time of his death as contained in a contract of marriage. Was this a will or a transfer *inter vivos* to take effect on death or a contract to leave property by will by each party in favour of the other?

In *Tezcan v. Tezcan*,[4] the British Columbia Court of Appeal held that an application by a wife, resident and domiciled in Turkey, for an order conveying to her an interest in two immovables in Vancouver which were in her husband's name, was properly characterized according to either the Turkish law or the law of British Columbia as a claim relating to immovable property governed by the *lex situs*. It was in essence a property claim which happened to arise within a marital context. Therefore, the Act determined the wife's rights in respect of the two immovables. The court rejected the argument advanced by the husband that all claims arising under the Act must be characterized as claims to movables because Part 3 of the *Family Relations Act* differs from other similar Canadian enactments which create only a payment obligation between spouses and do not, as does the British Columbia statute, create interests in movable and immovable property. It might have been better for the court to have recognized the personal remedial aspect of the *Family Relations Act* and to have characterized its property provisions as rights arising by virtue of marriage, to be governed by one system of law only, since the decision of the British Columbia Court of Appeal that the Act creates property rights means that the definition and division of each movable and immovable comprising the family assets must be done according to the law of its respective *situs*.[6]

In *Lecours v. Carrier*[7] the question was whether the liability of an employer towards his employees in the case of an accident was contractual, in which case Quebec law applied, or delictual and thus governed by the law of Maine. The choice between contract and tort was also the issue in *McLean v. Pettigrew*,[8] which involved the liability of the driver of an automobile towards a gratuitous passenger, while in *Gauthier v. Bergeron*,[9] the Court of Appeal for Quebec had to decide whether the vicarious liability of the owner of an automobile was to be characterized as a matter of personal status, tort or property. In *Lister v. McAnulty*,[10] the Supreme Court of Canada was faced with the characterization of incidents to status.

In *Pouliot v. Cloutier*,[11] the wife claimed that certain benefits had accrued to her under the terms of a statute of New Hampshire where the spouses had their domicile at the time of marriage. Her husband had died domiciled in the province of Quebec. Both Quebec and New Hampshire rules of the conflict of laws agreed that the succession was governed by the law of the deceased's last domicile, but the law of the matrimonial domicile at the time of the marriage governed the property rights of the spouses. The question before the court was whether the New Hampshire statute applied because the question was one of succession or whether it did not apply because the question was one of matrimonial property. Kerwin J., in deciding that the statute in question was successoral and therefore not applicable, quoted Falconbridge[12] to that effect:

> The prevailing view would seem to be that a statute of this kind in the absence of any clear indication of the legislature's intention, is to be characterized as being in effect a limitation on the testator's disposing power, and therefore as being testamentary law, applicable to immovable property situated within the territory of the enacting legislature and to movable property wherever situated of a testator domiciled in that territory.

In *Seifert v. Seifert*,[13] the provisions of an Ontario statute by which marriage revoked a will were held to be part of the matrimonial law and not of the testamentary law.

The question of whether the requirement of parental consent to the marriage of minors is a question of form governed by the *lex loci celebrationis* or a question of capacity governed by the law of the minor's domicile has been considered on a number of occasions. In Ontario the courts have followed the English case of *Ogden v. Ogden*[14] and held that it is a matter of form,[15] while in Quebec the majority of the courts have favoured the view that it is a matter of capacity.[16]

Westlake's view was that a consent which it is possible to do without in the domicile ranks, for the purpose of the conflict of laws, among the forms of marriage, and not among the conditions of capacity, but that "a consent which it is impossible to do without in the domicile ranks, for the purpose of private international law, among the conditions of capacity, and not among the forms of marriage". Perhaps, though a requirement of parental consent cannot be characterized in the abstract, and in all cases, either as a matter of the formalities of celebration or as a matter of the capacity to marry, but must be characterized in the context of the instant case. Consequently, a requirement of English law of parental consent might properly be characterized as a matter of formalities and therefore inapplicable to a marriage in Scotland or France between persons domiciled in England, but applicable to any marriage celebrated in England without regard to the domicile of the parties. A requirement of French law as to parental consent might properly be characterized as a matter of capacity and therefore applicable to a marriage celebrated in England between persons domiciled in France, but inapplicable to a marriage celebrated in France between persons domiciled in England.

A claim for a constructive trust of property accumulated during a relationship of cohabitation over many years was held to be properly characterized as one concerning unjust enrichment and not matrimonial property because the parties were not married.[17]

Two cases in the Supreme Court of Canada are of special interest, namely, *Kerr v. Kerr and A.-G. Ont.*,[18] and *A.-G. Alta. and Neilson v. Underwood*.[19] In the former case a statute of the province of Ontario, in the latter case a statute of the province of Alberta, were in question. In each case the statute required parental consent as a condition of the validity of the marriage of a minor in certain circumstances, and the question whether the statute was within the legislative jurisdiction of the province depended on its being legislation in relation to a matter coming within "The Solemnization of Marriage in the Province" in section 92 of the *Constitution Act, 1867*[20] (defining the scope of the provincial legislative powers), as distinguished from "Marriage and Divorce" in section 91 (defining the scope of the federal legislative powers). In each case the provincial statute was held to be *intra vires*, but in each case an important reservation was stated. In the *Kerr* case, Duff C.J. said:

> I must not be understood as expressing the view that it would not be competent to the Dominion, in exercise of its authority in relation to the subject of "marriage," in matters which do not fall within the subject of "solemnization of marriage," to deprive minors domiciled in Canada of the capacity to marry without the consent of their parents. No such question arises here, and it is quite unnecessary to pass an opinion upon it. The authority of the Dominion to impose upon intending spouses an incapacity which is made conditional on the absence of certain nominated consents is not in question.[21]

In the *Underwood* case, Rinfret J., delivering the judgment of the Court, said:

> The whole question depends upon the distinction to be made between the formalities of the ceremony of marriage and the status or capacity required to contract marriage. Solemnization of marriage is not confined to the ceremony itself. It legitimately includes the various steps or preliminaries leading to it. The statute of Alberta, in its essence, deals with those steps or preliminaries in that province. It is only territorial. It applies only to marriages solemnized in Alberta and it prescribes the formalities by which the ceremony of marriage shall be celebrated in that province. ? It does not pretend to deprive minors domiciled in Alberta of the capacity to marry outside the province without the consent of their parents. Moreover, it requires that consent only under certain conditions and it is not directed to the question of personal status ... .

It must further be understood that our judgment does not express any view as to the competency of the Dominion, in the exercise of its proper authority, to legislate in relation to the capacity to marry of persons domiciled in Canada. In the absence of legislation by the Dominion, that question does not arise here and is fully reserved. All that we decide in regard to it is that the Dominion legislation, as it stands, does not affect the present case.[22]

Characterization in the conflict of laws is akin to characterization as it may present itself in connection with the division of legislative power in Canada. In order to determine whether a particular statute is legislation in relation to a matter coming within a particular class of subjects in section 91 or section 92 of the *Constitution Act, 1867*, the true nature and character of the legislation must be determined, and regard must be had as to what the legislation was aimed at or devised for and what object it had in view. In the conflict of laws, the classes of questions or issues mentioned in various conflict of laws rules are described in such general terms as sometimes to render the rules ambiguous, and in order to decide whether a particular provision of the law of a given country relates to a matter which falls within the question or issue identified in one rule or the question or issue identified in another rule, it is necessary to determine the underlying nature or character of the provision in question. It happens that the *Kerr* and *Underwood* cases not only illustrate the solution of questions or issues of characterization in general, but they turn upon the distinction between formalities of solemnization of marriage on the one hand, and capacity to marry or intrinsic validity of marriage on the other hand, a distinction which is also material in the conflict of laws.

The nature of the requirement of a civil ceremony for a marriage was the main issue in *Berthiaume v. Dastous*.[23] The Privy Council decided that it pertained to form and not capacity, therefore a marriage celebrated in France by a priest without the prior civil ceremony required by French law was declared invalid even though the religious ceremony was sufficient according to the law of the domicile of the spouses.

In the common law provinces the courts have characterized the nature of an interest in a thing by the law of the place where it is located.[24] At common law the basic distinction between proprietary interests in things is the distinction between realty and personalty. In the conflict of laws, however, Anglo-American courts have generally adopted the civil law distinction between movables and immovables, although this is by no means universal, in order to arrive at a common basis on which to determine questions between persons living under different legal systems. This distinction is not co-extensive with the distinction between realty and personalty. Some courts, however, have held that the civil law distinction is not necessary when the conflict is between two jurisdictionsthat both recognize the distinction between realty and personalty.[25] This view was criticized as unsound by Robertson[26] and by Falconbridge.[27] Of course, after the governing law has been selected on the basis of the distinction between movables and immovables, the distinction between realty and personalty may become relevant again in order to apply the governing law.

In *Hogg v. Provincial Tax Commission*,[28] the Saskatchewan Court of Appeal had to characterize mortgages charged upon lands in British Columbia that were owned by a person who died domiciled in Saskatchewan. Applying the law of British Columbia, the Court held that they were immovables and thus not subject to the Saskatchewan *Succession Duty Act* of 1938 which applied only to "devolution by or under the law of the province."[29] If the mortgages had been characterized as movables they would have devolved according to the law of Saskatchewan by virtue of the rule *mobilia sequuntur personam*. The Court stated that "it is always to be borne in mind that the question whether certain property is a movable or immovable must be determined by the law of the country where it is situated."[30] Characterization by the *lex fori* in this context could lead to inconsistent determinations affecting title to real property.

Characterization is also a very important process in the field of products liability. If the plaintiff's claim is based on a warranty, it would probably be characterized as contractual. On the other hand, if it is based on negligence, breach of statute, or strict liability, the claim would probably be characterized as tortious. In the case of a claim based on breach of statute, characterization would depend upon the language used by the statute.

In *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*,[31] the Court had to distinguish between the validity of a security agreement as a contract and the validity of the security interest in the collateral. It also had to decide whether the effect of non-perfection of a security interest was a question of validity or one of priority.

[1] *Richardson v. RxHousing Inc.*, [2010] N.S.J. No. 631, 2010 NSSM 67, 297 N.S.R. (2d) 254 (claim for return of deposit on a rental in another country treated as a claim in contract).

[1.1] See Chapter 6 "Substance and Procedure". Note that characterization in the conflict of laws has nothing to do with the primary question of construction. See Mann, "The Primary Question of Construction and the Conflict of Laws" (1963) 79 L.Q. Rev. 525.

[2] [1936] O.J. No. 241, [1937] 1 D.L.R. 216 (C.A.).

[3] [1932] S.J. No. 50, [1932] 2 W.W.R. 533 (C.A.).

[4] [1992] B.C.J. No. 30, 87 D.L.R. (4th) 503 (C.A.), affg [1990] B.C.J. No. 498, 68 D.L.R. (4th) 277 (S.C.).

[5] [*Reserved*]

[6] As to whether the capacity to transfer land is an issue governed by the law applicable to the matrimonial regime of the parties or by the *lex rei sitae*, see *Landreau (Landry) v. Lachapelle*, [1937] O.J. No. 282, [1937] 2 D.L.R. 504 (C.A.), affg [1936] O.J. No. 235, [1937] 1 D.L.R. 87 (H.C.).

[7] (1924), 30 R.L. (N.S.) 193 (Que. C.A.).

[8] [1944] S.C.J. No. 49, [1945] S.C.R. 62, esp. Taschereau J., at 67. See also *R. v. Zien*, [1986] F.C.J. No. 93, 26 D.L.R. (4th) 121 (C.A.).

[9] [1973] Que. C.A. 77; Talpis, (1973) 51 Can. Bar Rev. 690; Groffier, (1973) 33 R. du B. 362.

[10] [1944] S.C.J. No. 34, [1944] 3 D.L.R. 673.

[11] [1944] S.C.J. No. 30, [1944] 3 D.L.R. 737.

[12] "Administration and Succession in the Conflict of Laws" (1934) 12 Can. Bar Rev. 125 at 133.

[13] [1914] O.J. No. 154, 23 D.L.R. 440 (H.C.). See also *Re Howard*, [1923] O.J. No. 19, 54 O.L.R. 109 (H.C.).

[14] [1908] P. 46 (C.A.).

[15] *Hunt v. Hunt* (1958), 14 D.L.R. (2d) 243 (Ont. H.C.J.).

[16] *Agnew v. Gober* (1910), 38 Que. S.C. 313 (C. of R.); *McClure v. Holford*, [1946] R.L. 126 (Que. S.C.), noted in Falconbridge (1946) 24 Can. Bar Rev. 219. *Contra: Redshaw v. Redshaw*, [1942] Que. S.C. 109.

[17] *Christopher v. Zimmerman*, [2000] B.C.J. No. 2051, 192 D.L.R. (4th) 476 (C.A.).

[18] [1933] S.C.J. No. 66, [1934] 2 D.L.R. 369.

[19] [1934] S.C.J. No. 43, [1934] 4 D.L.R. 167.

[20] *Constituton Act, 1867* (U.K.), 30 & 31 Vict, c. 3.

[21] [1933] S.C.J. No. 66, [1934] S.C.R. 72, at 75-76.

[22] [1934] S.C.J. No. 43, [1934] S.C.R. 635, at 639, 641. See also Le Mesurier (1935-36) 1 U.T.L.J. 350.

[23] [1930] 1 D.L.R. 849 (P.C.).

[24] See, for instance, *Dominion Bridge Co. v. British American Nickel Corp. Ltd.*, [1924] O.J. No. 124, 56 O.L.R. 288, at 292, [1925] 2 D.L.R. 138 (H.C.); In *Re Berchtold*; *Berchtold v. Capron*, [1923] 1 Ch. 192; *Re Burke*, [1928] 1 D.L.R. 318 (Sask. K.B.). As to contract or property, see *Re Intex Moulding Ltd.*, [1987] O.J. No. 346, 38 D.L.R. (4th) 111 (H.C.J.). In *War Eagle Mining Co. v. Robo Management Co.*, [1995] B.C.J. No. 2142, 13 B.C.L.R. (3d) 362 (S.C.), additional reasons at [1995] B.C.J. No. 2884, 16 B.C.L.R. (3d) 358, further additional reasons at [1996] B.C.J. No. 170, it was held that mineral claims situated in Saskatchewan under the law of which they were immovables did not lose this characterization even though by the *lex fori* they would have been characterized as movables.

[25] *Re Hole Estate*, [1948] M.J. No. 60, [1948] 4 D.L.R. 419 (K.B.), and "Comment" (1949) 27 Can. Bar Rev. 225 which relies on *Re Hoyles*; *Row v. Jagg*, [1911] 1 Ch. 179 (C.A.).

[26] *Characterization in the Conflict of Laws* (1940) at 201.

[27] *Essays on the Conflicts of Laws*, 2nd ed. (1954) at 540-41.

[28] [1941] 4 D.L.R. 501 (Sask. C.A.).

[29] S.S. 1938, c. 11, s. 3(2). At the time the case was heard: R.S.S. 1940, c. 50.

[30] *Hogg v. Provincial Tax Commission*, [1941] 4 D.L.R. 501, at 505 (Sask. C.A.) *per* Mackenzie J.A. See also *Macdonald v. Macdonald*, [1932] UKHL 3, [1932] S.C. 79, at 84.

[31] [1994] A.J. No. 723, 121 D.L.R. (4th) 360 (Q.B.).

§3.3 CHARACTERIZATION OF THE CONNECTING FACTOR

Characterization also includes the interpretation of the connecting factor in a conflict of laws rule of the forum.[1] For instance, what is meant by domicile in the conflict of laws rule that succession to movables is governed by the law of the last domicile of the deceased? Where is the situs of a bond in order to apply the lex situs to its transfer? Where was the tort committed or the contract made when the conflict of laws rule requires application of the *lex loci delicti* or the *lex loci contractus*? Even if the *lex fori* and the *lex causae* use the same connecting factor they might have different views as to its definition or location. For instance, according to English law the deceased may have died domiciled in France, whereas according to French law he or she may have died domiciled in England.[2]

It is widely accepted that in interpreting its own conflict of laws rules the court must apply its own characterization. The connecting factor is part of the conflict of laws rules of the *lex fori* and must be interpreted by that law. Thus, in common law Canada, a court dealing with any case involving domicile will apply its own rules to the determination of this connecting factor.

[1] Specific instances of interpretation of this connecting factor will be discussed in Chapter 4 "The Connecting Factors of Domicile and Residence".

[2] As was the case in *Re Annesley*; *Davidson v. Annesley*, [1926] Ch. 692.

§3.4 INCIDENTAL OR PRELIMINARY QUESTION

In characterizing the principal question containing relevant foreign elements, it may become apparent that there is a subsidiary question, arising out of the principal question, which also contains relevant foreign elements.

For instance, in *Schwebel v. Ungar*,[1] the defendant and her first husband were refugees who had been married in Hungary when they were domiciled there. On their way to Israel, while in a refugee camp in Italy, they were divorced by a "gett" which, although recognized by the law of Israel, was not recognized by either the law of Hungary or the law of Italy as a valid dissolution of their marriage. The parties acquired a domicile of choice in Israel. Several years later, the defendant, who by the law of Israel had the status of a single woman, married the plaintiff in Ontario. The latter then sought a declaration of nullity on the ground that the defendant's marriage with her first husband had not been dissolved by a divorce that would be recognized in Ontario.

The principal question—the defendant's capacity to marry the plaintiff—was by virtue of the relevant Ontario conflict of laws rule, governed by the law of Israel, her domicile at the time of her second marriage. The incidental question—the validity of the divorce granted by a rabbinical court in Italy—was capable of arising of its own right and, as such, could have been governed by the law of Hungary as the domicile of the original spouses. If the Ontario conflict of laws rule was applied, the law of the domicile of the spouses at the time of the petition for divorce would govern. The court was asked to decide whether the conflict of laws rule of Israel (the *lex causae*) or of Ontario (the *lex fori*) applied to the incidental question.[2]

The Supreme Court of Canada,[3] in affirming the decision of the Ontario Court of Appeal, held that the defendant had the capacity to remarry in Ontario by virtue of the law of Israel, which recognized her first divorce as valid. The rules on the recognition of divorces of the country, whose law governed the principal question were applied to the incidental question.[4]

In another example of an incidental question, if a man possessed of movables in Ontario dies domiciled in X without having made a will and leaving a wife and a brothersurviving him, a court in that province would, by virtue of its conflict of laws rules, apply the law of X to determine whether or not the wife is entitled to a share of these movables. If the brother questions the validity of the marriage because of a defect of form by the *lex celebrationis* or because of a prior invalid divorce in country Y, by what law should these questions be determined? Here, the principal question is one of intestate succession to movables, whereas the incidental question is the validity of the foreign marriage or divorce, and the incidental question is whether or not she was the wife of the deceased. Thus Wolff[5] pointed out that the incidental question is both a preliminary and a subsequent question. Before claiming a share of her husband's estate by virtue of the law of X, she must first prove that she was his wife. However, the issue of her status as a wife cannot arise until after the selection of the law of X by virtue of the conflict of laws rules of the forum applicable to succession to movables which allows her to claim a share of the estate of her intestate husband. The incidental question is either preliminary or subsequent, depending upon whether one examines the order in which the questions must ultimately be solved or the order in which they arise for consideration.[6]

When faced with an incidental question, the court must consider the basic issue of whether the appropriate conflict of laws rules of the forum or of the country whose law is applicable to the principal question should be applied to the incidental question.[7] In this regard, the incidental question raises an issue similar to that raised by *renvoi* in that it can call upon the court to apply a foreign law that is identified by the conflict of laws rules of the *lex causae* rather than by its own conflict of laws rules.[8]

There is no general agreement that the conflict of laws rules of the country whose law governs the principal question, that is the *lex causae*, should be applied to the incidental question. In the very few cases where an incidental question has been present, the courts have not openly favoured a particular rule. In Canada, in *Schwebel v. Ungar*, only by inference from the result arrived at on the facts of the case can it be said that the conflict of laws rules of the *lex causae* was applied to incidental questions. Canadian authors differ in their views. Falconbridge[9] preferred to apply to incidental questions the system of domestic law indicated by the conflict of laws rules of the forum applicable to the principal question subject to certain exceptions, whereas Gotlieb[10] rejected the search for a general principle as illusory and believed that "there is really no problem of the 'incidental question,' but as many problems as there are cases in which incidental questions may arise." Lysyk[11] in his comment upon *Schwebel v. Ungar* argued that since the paramount objective of the conflict of laws must always be to achieve international uniformity of results, the *lex causae* should be applied to incidental questions in order to avoid disparity of results on the principal question. However, he pointed out that such international uniformity of results would bring about internal dissonance. He concluded that, in practice, the risk of internal dissonance will exert a stronger influence in the court's selection of alternatives than the inevitable risk of reaching a result different from that which might be arrived at in another country. If this was so, then these considerationsshould have prompted the courts in *Schwebel v. Ungar* to apply to the incidental question the relevant conflict of laws rule of the forum rather than that of the *lex causae.*

It seems unwise to propose, in the abstract, rigid or doctrinaire rules for the resolution of questions likely to be affected by compelling issues of equity between the parties, and of broad public policy. It is better simply to be aware of the implications of the incidental question for the choice of law analysis.

[1] [1963] O.J. No. 846, 42 D.L.R. (2d) 622 (C.A.), affd [1964] S.C.J. No. 57, 48 D.L.R. (2d) 644.

[2] Actually, the divorce was recognized by the law of Israel not as a result of a true conflict of laws rule, but because Israeli courts recognize any divorce obtained in conformity with the requirements of Jewish law. For Canadian rules for the recognition of foreign divorces, see Chapter 17 "Matrimonial Causes".

[3] [1964] S.C.J. No. 57, 48 D.L.R. (2d) 644.

[4] See Lysyk (1965) 43 Can. Bar Rev. 363.

[5] *Private International Law*, 2nd ed. (1950), at 206.

[6] Robertson, *Characterization in the Conflict of Laws* (1940), at 137. In *Edward v. Edward Estate*, [1985] S.J. No. 130, 44 Sask. R. 266 (U.F.C.), affd [1987] S.J. No. 423, 39 D.L.R. (4th) 654 (C.A.), recovery under *The Dependants' Relief Act*, R.S.S. 1978, c. D-25 depended upon the validity of the applicant's marriage, which in turn depended upon the validity of her alleged husband's divorce in California. Now see *Dependants' Relief Act, 1996*, S.S. 1996, c. D-25.01.

[7] Gotlieb, "The Incidental Question in Anglo-American Conflict of Laws" (1955) 33 Can. Bar Rev. 523; and "The Incidental Question Revisited—Theory and Practice in the Conflict of Laws" (1977) 26 I.C.L.Q. 734.

[8] See Chapter 5 "Renvoi".

[9] (1939) 17 Can. Bar Rev. 369, at 377-78.

[10] (1955) 33 Can. Bar Rev. 523, at 555.

[11] (1965) 43 Can. Bar Rev. 363.

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CHAPTER 30

FOREIGN CORPORATIONS

§30.1 STATUS, POWERS, DOMICILE, RESIDENCE AND NATIONALITY

Corporations and other legal persons or juridical entities duly created in foreign states or in other provinces or territories, are recognized and permitted to sue and be sued[1] in Canada in their corporate capacity[2] subject, in certain cases,[3] to registering or obtaining a local licence.[4] However, a foreign corporation's failure to obtain a provincial licence does not immunize it against suits brought against it in any of the provinces or territories nor does it affect its corporate existence.[5]

Questions concerning the status of a foreign corporation, especially whether it possesses the attributes of legal personality, are, on the analogy of natural persons, governed by the law of the domicile of the corporation.[5.1] This domicile is in the state, province or territory of incorporation or organization and it cannot be changed during the corporation's existence even if the corporation carries on business elsewhere.[6]

The law of the state, province or territory under which a corporation has been incorporated or organized determines whether it has come into existence, its corporate powers and capacity to enter into any legal transaction,[7] the persons entitled to act on its behalf[8] including the extent of their liability for the corporation's debts,[9] and the rights of its shareholders.[10] Furthermore, the instrument of incorporation and the laws of a corporation's domicile govern not only its creation and continuing existence, but also all matters of internal management, the creation of share capital and related matters.[11] The issues governed by the law of the corporation's domicile include its capacity to sue, the authority of directors, who may be appointed a director, its power to make contracts, the validity of conveyances of corporate property, the corporation's right to issue stock, and the validity of transfers of its stock.[12]

While the state, province or territory in which the foreign corporation intends to carry on business has the right to prescribe the extent to which the corporation may exercise its corporate powers and capacity, this does not mean that proceedings may be taken in this jurisdiction to affect its status as a corporation.[13] However an important exception to this exists in respect of a foreign partnership formed solely for the purposes of creating a tax loss in the forum and not for doing business. The existence of such a partnership will be determined by the law of the forum.[14]

There is some controversy over which law determines the liability of a corporation for the obligations of a foreign subsidiary. Since the personality and status of the subsidiary is called into question, it would seem that the law applicable to the status and capacity of the subsidiary should determine whether its corporate veil can be pierced. Alternatively, under the technique of *depeçage* the court could apply the *lex fori* to jurisdiction as a matter of procedure in order to determine the identity of the true defendant but this would encourage forum shopping for the jurisdiction most favourable to piercing the corporate veil. For other matters, the law governing the contract or tort that in a particular country may be seen as an implicit selection of that country's law as the proper law.[55] Even if, objectively, the contract is more closely connected with another jurisdiction, the selection of the place of arbitration may amount to an implied agreement as to choice of law.[56] The same inference may be drawn if the form of the arbitration agreement itself complies with the law of the place of arbitration but not with the other possible governing law.[57]

However, the inference was not drawn in a case in which the parties and the performance of the contract were all connected with two foreign legal systems whilst the arbitration was in a third country. The foreign connections outweighed the significance of the place of arbitration and the proper law had to be selected on the basis of the other connections.[58] Irrespective of the proper law of the contract as such, the parties will usually be taken to have intended that the law of the place of arbitration will govern issues relating to the arbitration procedure.[59]

An agreed selection of a judicial forum in a particular country is a strong indication that the parties intended the law of that country to apply to the contract.[60] It is a stronger indication than an arbitration agreement because a court, unlike an arbitrator, is bound to apply the law of the country in which it sits unless that country's choice of law rules authorize it to apply foreign law. By contrast, an arbitral tribunal has no *a priori* legal obligation to apply the law of the country in which the arbitration takes place or, for that matter, any specific other law, since its powers derive, not from a national law, but from the parties' agreement.[61]

Rome I includes in its preamble a statement that says that an exclusive choice of forum in favour of the courts or tribunals of a member state "should be one of the factors to be taken into account in determining whether a choice of law has been clearly demonstrated [for the purposes of article 3, paragraph 1, the provision giving the parties freedom of choice]".[62] The OAS Convention puts it negatively: "Selection of a certain forum by the parties does not necessarily entail selection of the applicable law."[63]

c. Proper Law Objectively Determined

i. The Closest and Most Real Connection Test

If the parties have not agreed on the proper law of their contract, the proper law depends on the "objective" test first treated as definitive in the *Bonython* case,[64] namely, "the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connection".[65] The *Bonython* test, which (like the "proper law" label) derives from Westlake,[66] superseded the earlier habit of referring to the proper law, even where the parties had not agreed on one, as being a matter of the parties' intention. As noted earlier,[67] this approach failed to mark the distinction between cases in which the parties' agreement on a proper law, though not express, could still legitimately be inferred from the contract's terms, and those in which the parties had simply not agreed on the proper law. In the latter case the intention could only be imputed. Treating it as if it were inferred from the terms of the agreement was a fiction.

The *Bonython* "closest and most real connection" test makes it clear that the process required, when construction of the contract has not yielded an express or implied choice of law by the parties, is a choice of law by the court. The same distinction is reflected in the European Rome I Regulation.[68] Article 3 reads, "A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract." Article 4 then specifies a set of tests for determining the governing law "[t]o the extent that the law applicable to the contract has not been chosen in accordance with Article 3". The OAS Convention similarly distinguishes between an express or implied agreement on the governing law, and an objective determination of the governing law based on the state with which the contract "has the closest ties".[69]

ii. Factors Considered

All the circumstances relating to the parties and to the contract are potentially relevant in determining the proper law using the *Bonython* test. Some significance has been attached to the distinction between a connection with a "system of law" and a connection with a "country". The former might suggest that legal factors such as the style of drafting of the contract, which relate more to the "system of law", are predominant over merely geographic factors such as the place where the contract was made or was to be performed, which relate more to the "country". It is clear, however that the test embraces both kinds of factors without giving more weight, *a priori*, to one than the other.[70]

Although the proper law is now determined according to an "objective" test and not by imputing a fictitious intention as to the governing law,[71] it is still important to take into account the parties' intentions, not as to the governing law (which, *ex hypothesi*, they did not have), but as to how their contract is to operate. Supporting those intentions was the main orientation of the imputed intention test, and it is no less so in respect of the "closest and most real connection" test.[72] Courts have generally assumed that the system of law that is chosen by means of this test should, if possible, be one that will enable, rather than weaken or negate, the contemplated operation of the contract.[73] This assumption underlies the often decisive weight given to the agreement's being drafted in a form or with legal concepts that are used in one jurisdiction but not another.[74] It also underlies the weight sometimes given to the fact that the contract is valid according to one system of law but invalid according to another.[75]

However, there are limits to the logic that the choice of governing law should respect the parties' interests. The proposition makes sense if the issue is the "fit" of the agreement with the general rules for contracts; it is appropriate to take into account the fact that the contract functions better under one law than another.[76] On the other hand, the proposition is inapposite if the issue is the application of a regulatory statute. Such a law is meant to override the parties' interests rather than give effect to them, and so the mere fact that the parties' interests are harmed is no reason for tilting the choice-of-law scales against that system of law.[77]

The place the contract is concluded has no *a priori* centrality in the "closest connection" analysis, although it is a relevant factor.[78] In the nature of things, its weight in the analysis is greatest when the parties are both resident in the country where the contract is made,[79] and least if the parties are from different jurisdictions and the place of contracting is just the outcome of a rule about whether an acceptance takes effect when (and therefore where) it is sent or when it is received.[80]

Other factors that have been regarded as relevant to the "closest and most real connection" analysis include the form and legal concepts in accordance with which the contract is drafted;[81] the language in which it is written;[82] the fact that the agreement is supplementary to another agreement governed by a particular law;[83] the fact that one party sought out the other in the latter's home country to make the contract;[84] the fact that the contract was negotiated in a particular place;[85] the location of the property that is the subject matter of the contract;[86] the place where property securing the payment of a debt instrument is located;[87] the flag of the ship on which a contract of carriage is to be performed;[88] the location of the office at which an account is to be operated;[89] the place where delivery of goods or provision of services is to take place;[90] the place where a loan or debt instrument is to be repaid;[91] the office at which decisions as to issuing an insurance policy were made;[92] the place where the services under a contract of employment are to be performed;[93] the place where a company insuring itself against risks in multiple jurisdictions[94] or hiring employees of multiple nationalities[95] was based; and the currency in which obligations are to be paid.[96]

The proper law must be determined as of the time the contract was made, which means that connections that emerge subsequently cannot be factored into the analysis.[97]

See further the discussion of particular types of contract, below.[98]

iii. Presumptions

Although at one time the common law choice of law rules made some use of presumptions,[99] the case law of the last few decades has abandoned them altogether. This contrasts with the choice of law rules in the *Civil Code of Québec* and the European Rome I Regulation for cases in which the parties have not agreed on a governing law. As noted below,[100] both of these pieces of legislation take as their starting point that the contract is governed by the law of the country in which the party that is to provide the "characteristic performance" is resident or, in a commercial contract, has its place of business. The Quebec *Civil Code* refers to this as a presumption, Rome I more strongly expresses it as a rule to be displaced only if the contract is manifestly more clearly connected with another jurisdiction.

Many of the common law decisions are consistent with the "characteristic performance" criterion, in that the most closely connected law was found to be that of the country of residence or the place of business of the party rendering the characteristic performance, which generally means the party who is selling or supplying the subject matter of the contract, whether property or services. But other cases have held that another law is the most closely connected law. For instance, there are sale of goods cases in which (especially where installation or after-sales technical assistance was part of the contract) the proper law was found to be the law of the purchaser's jurisdiction, not the seller's.[101]

iv. More than One Proper Law

It is possible for the closest connection test to result in a contract being governed by one system of law as to one part, and by another system of law as to another, severable part.[102] The OAS Convention caters expressly to this possibility.[103] An English court found this to be the case, in relation to a contract with a bank that provided for the operation of two accounts, one in London and the other in New York. The relations between banker and customer were held governed by English law as to the former account and by New York law as to the latter.[104]

CHAPTER 32

UNJUST ENRICHMENT

§32.1 THE LAW OF THE OBLIGATION TO MAKE RESTITUTION

It is particularly challenging to identify the law governing the obligation of a person to make restitution for an unjust enrichment enjoyed at another person's expense because the obligation is not a cause of action but a remedy appropriate for situations in which a wrong sounds more in the gain to the wrongdoer than the loss to the victim.[1] Since choice of law rules tend to be based on the elements of a cause of action and not on the appropriate consequences of seeking relief, the law governing a claim for unjust enrichment will depend on the nature of the wrong giving rise to the claim.[2]

For instance, where the obligation arises in connection with a pre-existing contractual relationship either actual or intended, the obligation is most closely connected with the law applicable to the contractual relationship.[3] Similarly, the obligation to restore the benefit of an unjust enrichment in connection with a person's ownership of an immovable may have its closest and most real connection with the law of the legal unit where the immovable is situated.[4] Where an obligation arises in connection with both a pre-existing contractual relationship and a transaction involving foreign land, a principled approach would be to examine all the factors relevant to the strength of the connection between the obligation and the competing legal systems and to give them weight according to their relative importance to the issues at stake. These factors could include:

- where the transaction underlying the obligation occurred or was intended to occur;
- where the transaction underlying the obligation was or was intended to be carried out;
- where the parties are resident;
- where the parties carry on business;
- what the expectations of the parties were with respect to governing law at the time the obligation arose; and
- whether the application of a particular law would cause an injustice to either of the parties.[5]

Alternatively, it has been proposed that the law governing restitutionary claims in general should be the "law of the unjust factor."[6] Should an analysis based on this approach fail to yield a compelling result, the obligation to restore the unjust enrichment could be regarded as more closely connected with the law of the place where the immediate or ultimate enrichment occurred since the enrichment is at the heart of the action[7] and "the law of the place of the defendant's enrichment is more closely connected with the defendant than the law of the place of the plaintiff's impoverishment."[8]

The proper law of the restitutionary obligation should determine the nature of the appropriate proprietary or personal remedies available to the claimant to rectify the unjust enrichment, for instance, the imposition of a constructive trust,[9] an accounting for profits, an equitable lien or charge, tracing property or its proceeds into the hands of a third party,[10] or compensatory damages. This is so despite the fact that remedies are often otherwise regarded as matters of procedure because the law of restitution is a remedial form of substantive law which includes whatever remedies are provided by that law to reverse the unjust enrichment. However, if the court where the claimant seeks to rectify the unjust enrichment is of the opinion that restitutionary remedies should be characterized as procedural law on the ground that historically equitable remedies are in the discretion of the court, it will apply the local remedies. Such a characterization should be adopted only where the forum cannot conveniently apply the relevant foreign remedy.[11]

[1] Panagopoulos, *Restitution in Private International Law* (2000); Rose, ed., *Restitution and the Conflict of Laws* (1995); Bennet, "Choice of Law Rules in Claims in Unjust Enrichment" (1990), 39 Int. & Comp. L.Q. 136; White, "Equitable Obligations in Private International Law: The Choice of Law" (1986), 11 Syd. L. Rev. 92; Barnard, "Choice of Law in Equitable Wrongs: A Comparative Analysis" (1992), 51 C.L.J. 474; Briggs, "Restitution Meets the Conflict of Laws" (1995), 3 Rest. L. Rev. 94; Collins, *et al.*, ed., *Dicey and Morris on the Conflict of Laws* (13th ed., 2000), rule 200. Scoles and Hay, *Conflict of Laws* (1982) at 699 *et seq.* Where a person makes a gain through breaching a contract, the claim is an enrichment claim but it might be characterized as a contract claim arising from breach of contract. Enrichment for wrongs not involving tortious conduct should be included in the category of unjust enrichment, not that of torts.

[2] For an excellent analysis see Bird, "Choice of Law" in Rose, ed., *ibid.* at 64 *et seq.* Also Stevens, "The Choice of Law Rules of Restitutionary Obligations" *ibid.* at 180 *et seq.* For a flexible approach see *Restatement of the Law, Second, Conflict of Laws 2d* (1971), § 221; and Hay, "Unjust Enrichment in the Conflict of Laws: A Comparative View of German Law and the American Restatement 2d" (1977), 26 Am. J. Comp. L. 1.

[3] *Barclay's Bank plc v. Incorporated Inc.*, [1999] A.J. No. 145, 242 A.R. 18 at 28 (Q.B.); *Fibrosa v. Fairburn*, [1943] A.C. 32; *Etler v. Kertesz*, [1960] O.R. 672, 26 D.L.R. (2d) 209, esp. at 223–24 (C.A.); *Libyan Arab Foreign Bank v. Bankers Trust Co.*, [1989] Q.B. 728, where the plaintiff's alternative claim for restitution at common law was rejected. Comp. Quebec *Civil Code*, S.Q. 1991, c. 64, art. 3125 which calls for the application of the law of the state where the act conferring the enrichment was done which is generally where the enrichment is received: "Obligations based on management of the business of another, reception of a thing not due or unjust enrichment are governed by the law of the place of occurrence of the act from which they derive."

[4] Collins, *et al.*, ed, *Dicey and Morris on the Conflict of Laws* (13 ed., 2000) rule 200(2)(b).

[5] *Minera Aquiline Argentina SA v. IMA Exploration Inc.*, [2006] B.C.J. No. 1626, 2006 BCSC 1102, affd [2007] B.C.J. No. 1232, 2007 BCCA 319, leave to appeal denied [2007] S.C.C.A. No. 424.

[6] Panagopoulos, *Restitution in Private International Law* (2000).

[7] *Arab Bank New York Ltd. v. Barclay's Bank*, [1952] 2 T.L.R. 920 at 924; *Re Jogia (A Bankrupt)*, [1988] 2 All E.R. 328; *El Ajou v. Dollar Land Holdings Ltd.*, [1993] 3 All E.R. 717 at 736 (Ch. D.); *Hongkong and Shanghai Banking Corp. v. United Overseas Bank*, [1992] 2 S.L.R. 495; *Trahir v. Pertamina*, [1994] 3 S.L.R. 257. Also *Chase Manhattan Bank N.A. v. Israel-British Bank (London) Ltd.*, [1981] Ch. 105. See also *Christopher v. Zimmerman*, [2000] B.C.J. No. 2051,

192 D.L.R. (4th) 476, [2000] 10 W.W.R. 437, 144 B.C.A.C. 152, 35 E.T.R. (2d) 6, 80 B.C.L.R. (3d) 299 (C.A.); revg [2000] B.C.J. No. 48, 31 E.T.R. (2d) 172, 4 R.F.L. (5th) 195 (S.C.).

[8] Bird, *supra*, note 2 at 114.

[9] As to constructive trusts see *supra*, chapter 28, Trusts. Also *Becker v. Pettkus*, [1980] 2 S.C.R. 834, 117 D.L.R. (3d) 257; *Re Sefel Geophysical Ltd.*, [1988] A.J. No. 917, 54 D.L.R. (4th) 117 (Q.B.); *Union Bank of Switzerland v. Batky*, [1998] O.J. No. 874, 24 C.P.C. (4th) 157 (Div. Ct.).

[10] *Chase Manhattan Bank v. Israel-British Bank (London) Ltd.*, [1981] Ch. 105; *El Ajou v. Dollar Land Holding Ltd.*, [1993] 3 All E.R. 717 (Ch. D.); *MacMillan Inc. v. Bishopsgate Investment Trust plc (No. 3)*, [1995] 3 All E.R. 747 (Ch. D.), affd [1996] 1 All E.R. 585 (C.A.) comment by Bird, [1995] Lloyd's M.L.Q. 308. Also Stevens, "Restitution or Property? Priority and Title to Shares in the Conflict of Laws" (1996), 59 Mod. L. Rev. 741.

[11] See *Tolofson v. Jensen*, [1994] S.C.J. No. 110, [1994] 3 S.C.R. 1022, 120 D.L.R. (4th) 289.

§32.2 QUÉBEC

Article 3125 of the *Civil Code* Provides: "Obligations Based on management of the business of another, reception of a thing not due or unjust enrichment are governed by the law of the place of occurrence of the act from which they derive."

The connecting factor is not always easy to ascertain. In the case of unjust enrichment, the rights and liabilities of the parties are created by the enrichment. Thus, it would seem that this article refers to the law of the place where the enrichment was received.[1] This law governs a person's right to recover the amount by which another person has been unjustly enriched at his or her expense and the remedies available for this purpose. Article 3125 could be used in the case of a constructive trust.[2]

[1] *Droit de la famille – 122854*, [2012] J.Q. no 10167, 2012 QCCS 5169, at para. 15.

[2] But see, *Droit de la famille – 2398*, [1996] R.J.Q. 1010 (S.C.).

[The next page is 33-i]

TAB 112

Report on the statutory review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* by the legislative review task force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals.

July 15, 2014

1. INTRODUCTION

The joint legislative review task force (Commercial) of the Insolvency Institute of Canada ("**IIC**") and the Canadian Association of Insolvency and Restructuring Professionals ("**CAIRP**") (the "**JTF**") respectfully submits this report to Industry Canada ("**IC**") and to its sponsoring organizations, IIC and CAIRP. The JTF was appointed jointly by these two (2) leading national organizations, represented regionally across Canada in terms of diversity and type of practice. A detailed account of the composition and methodology of the JTF is attached hereto as Schedule A to this report.

At this early stage of legislative review, the mandate of the JTF is to provide objective non-partisan comments on the various issues raised in Industry Canada's ("**IC**") discussion paper entitled "*Statutory Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*" (the "**Discussion Paper**") in the context of the public consultation process launched by IC in May 2014. The JTF's mandate also encompasses the identification of issues which may not be addressed in the Discussion Paper but which, in the JTF's view, should be considered in the next round of legislative reform of the Bankruptcy and Insolvency Act ("**BIA**")[1] and the Companies' Creditors Arrangement Act ("**CCAA**")[2].

At the outset, it is important to note the following in regard to the scope of the JTF's mandate and related report:

- like the Discussion Paper, this report does not contain formal recommendations with respect to eventual legislative reform of the BIA and CCAA. Although some of the comments may suggest a direction in legislative changes, these should be considered as a starting point for further research on legislated solutions. Recommendations will be made at a later stage of legislative reform and will involve, *inter alia*, additional research, collective reflection on certain issues considered worthy of reform as well as the polling of members of IIC and CAIRP.

- this report focuses on corporate and commercial issues and topics raised in the Discussion Paper which are related to commercial and corporate bankruptcy and restructuring. Issues related to consumer bankruptcy and insolvency are addressed in a distinct report prepared by the CAIRP Consumer Advocacy Task Force.

2. EXECUTIVE SUMMARY

The majority of issues and topics raised in the Discussion Paper are relevant and worthy of further consideration in the context of the eventual reform of the Canadian statutory insolvency regime. While the 2009 global reform of the BIA and CCAA resulted in significant improvement and modernization of these statutes, the JTF wholeheartedly supports periodic Parliamentary review of the BIA and CCAA with a view to improving the statutory regime and ensuring that it remains relevant and functions effectively in a changing market place. Each of the issues raised in the Discussion Paper in respect of commercial restructuring or insolvency is commented in greater detail hereunder, in section 3.

[1] RSC 1985, c. B-3, as amended.

[2] RSC 1985, c. C-36, as amended.

The JTF has also identified certain issues and topics not otherwise raised in the Discussion Paper which are, in its view, worthy of consideration in the next round of legislative reform of the BIA and CCAA. Such additional issues and topics are raised, when relevant, in the comments made with respect to commercial issues contained in the Discussion Paper and are also outlined in section 4 of the present report.

3. COMMENTS OF THE JTF WITH RESPECT TO THE COMMERCIAL ISSUES RAISED IN THE DISCUSSION PAPER

Commercial issues raised in the Discussion Paper are hereafter addressed in the order in which they appear therein.

3.1 Encouraging innovation through Intellectual Property Rights - Copyrights and Patented Items, 2009 Amendments in respect of the rights of IP licensees

IC has requested submissions regarding how to improve the existing rules to support the objective of encouraging innovation, while also balancing the competing interests in an insolvency proceeding.

JTF Comments

The treatment of intellectual property rights in the context of insolvency is, in the JTF's view, a very important topic which needs to be addressed in the next round of legislative reform. Existing provisions of the BIA regarding the rights of the holders of patents[3] and of copyrights[4] were adopted early in the twentieth century and are clearly outdated in a market place where intellectual property rights such as software licenses constitute assets of significant value.

Furthermore, although changes were made in the last round of reforms (the "**2009 Amendments**")[5] that seek to protect intellectual property licensees in the face of an insolvency of the licensor while maintaining the ability of the licensor to restructure or preserve value,[6] there has been some criticism of the provisions, as the protection they afford is thought to be scant, in particular considering that the acquisition and maintenance of the intellectual property by the licensee may be very expensive, and its continued accessibility, without restriction, may be crucial to the licensee's business.

The JTF considers additional research is warranted to assess ways to modernize the provisions of the legislation that deal with intellectual property, and to assess whether the 2009 Amendments strike the proper balance between the rights of licensees to enjoy the intellectual property they have a contractual right to use and the rights of licensors to restructure.

The following section addresses various issues considered by the JTF to be worthy of consideration and further research in order to improve the treatment of intellectual property rights in a context of insolvency.

[3] Section 82 BIA.

[4] Section 83 BIA.

[5] *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts,* S.C. 2005, c 47 as amended and complemented by *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada*, 2005, S.C. 2007, c 36

[6] Sections 65.11(7) and 84.1 BIA and sections 11.3 and 32(6) CCAA.

3.1.1 Issue raised by IC : Proposals for the reform of Section 82 and 83 of BIA :

The modernization of the treatment of intellectual property ("**IP**") rights in a context of bankruptcy is, in the JTF's view, worthy of consideration.

The concept of "intellectual property" is much broader than traditional forms of intellectual property such as patents and copyright in respect of manuscripts which presently benefit from limited protection under sections 82 and 83 of the BIA. BIA and CCAA should perhaps be amended to include a broader, detailed and flexible definition of intellectual property as such non-inclusive definition of IP would provide greater clarity to practitioners and stakeholders. Any definition of IP should remain flexible and non-exhaustive in order to take into account concerns arising from the rapid change in IP and laws relating to IP.

The Intellectual Property Owners Association[7] has recently adopted a resolution supporting the inclusion of trademarks, service marks and trade names in the definition of IP in the *American Bankruptcy Code*. Some recent US caselaw[8] has navigated around the existing exclusion of trade-marks in the United States. An examination and consideration of the American experience and jurisprudence in this regard may be a good starting point for considering how the definition of IP should be developed.

Reliability of the insolvency system and the protection of IP rights play a vital role in attracting domestic and foreign investment as well as promoting entrepreneurship and innovation.

In the context of balancing these interests, insolvency laws should provide a clearer indication of how various types of IP will be affected upon insolvency. The following guidelines should be considered in this regard:

- Consider developing a definition of IP which provides descriptions of various IP rights and interests that is not static and is capable of evolving with the rapid evolution of IP and IP law.

- Consider whether different types of IP should attract different treatment and whether that treatment will be different depending on the outcome of the insolvency process (restructuring vs liquidation).

- Reform on these issues should be cautious and mindful when considering statutory definitions, classifications and differences in the treatment of IP to avoid a result which may be too "rule based" and categorical and which does not sufficiently provide flexibility and judicial discretion to interpret and apply the provisions on a principled, organic and evolutionary manner.

3.1.2 Issue raised by IC : Effectiveness of the 2009 Amendments regarding the limited consequences of termination of contracts

The JTF is of the view that the effectiveness of the 2009 Amendments with respect to the consequences of terminating contracts regarding the use of IP is worthy of consideration.

[7] https://www.ipo.org/index.php/advocacy/board-resolutions/2014-board-resolutions/

[8] "See *Re Interstate Bakeries Corporation v. Interstate Brands Corporation*, 2014 U.S. App. Lexis 10537 (8th Cir. 2014); *Re Exide Technologies*, 607 F. 3d 957 (3d Cir. 2010).

Some of the related issues to be considered in this respect are the following:

- Should there be distinctions in how IP rights are treated depending on the statute under which proceedings are commenced and/or the type of proceedings which are commenced?

- Different treatment of IP rights may result in statute shopping for debtors whose principal assets are IP, such as technology, content and branding businesses. To promote harmony and certainty, IP rights should be treated similarly whether the process chosen is under the BIA, CCAA or receivership.

- Some of the licensee protections introduced in 2009 apply if the licensor restructures but not in a bankruptcy or receivership context. The 2009 Amendments do not address a receiver's ability to disclaim agreements whereas an insolvent person is explicitly permitted to disclaim agreements under section 65.11 BIA.

- The outcome of the proceedings (liquidation vs restructuring) ought to be the primary factor to influence the manner in which IP rights are treated, rather than the choice of statute or proceeding.. For example, IP rights should be treated the same regardless of whether a liquidation takes place under the BIA or the CCAA. Similarly, IP rights should be treated similarly where the end result of a process is a restructured company which continues to operate. Furthermore, it may be advisable to consider whether there should be a defined period during which trustees must decide how to treat IP rights in a bankruptcy.

3.1.3 Treatment of IP rights subject to a sale through insolvency proceedings

While this related issue is not specifically addressed in the Discussion Paper, the JTF believes that the manner in which IP rights are treated where asset sales are conducted in the context of insolvency proceedings is worthy of consideration.

Depending on the type of underlying IP at issue, an insolvent licensor may be able to sell IP free and clear of current licenses in certain circumstances to maximize value of the estate. This creates uncertainty and may be detrimental to the interests of licensees.

A more certain approach which has the flexibility to accommodate unique situations should be considered, Protecting IP rights and maximizing value for the estate can produce competing tensions and the difficulty is finding the appropriate balance between those tensions.

Currently, parties that rely on the IP assets of another person (such as a licensee and franchisees reliant on the trade-marks of franchisors) are not explicitly required to receive notice of a sale of IP.

The following questions thus deserve further reflection and consideration in this regard:

- Should there be a notice regime or claims process whereby IP holders who may be affected are given an opportunity to participate in the process and be recognized as a stakeholder entitled to further notice in the proceedings?

- Should licensees be provided a right of first refusal to purchase the licensor's IP?

- To the extent that IP rights are negatively affected, should the parties so affected be provided with an opportunity to appear in court and object to the relief that may affect their IP rights?

- Should it depend on whether there may be a material negative impact or should there be another threshold or test?

3.1.4 IP rights of licensees upon the insolvency of a licensor

The 2009 Amendments were aimed at reducing uncertainty faced by IP licensees in an insolvency restructuring, in a manner similar to the protection afforded to licensees under the *US Bankruptcy Code*[9].

While the debtor can unilaterally disclaim most agreements under the CCAA and BIA, there is a carve-out which limits the consequences of such disclaimer when it relates to a contract for the "use" of IP (such as license agreements).[10].

However, these carve-outs apply only with respect to the "use" of IP. While IP licensees whose licenses have been disclaimed may continue to use the IP as long as they continue to perform their obligations under the license, they are unable to obtain the benefits of other covenants under the license such as access to source codes or further updates or service / maintenance.

Forcing licensors to honour the terms of otherwise disclaimed licenses may unduly hamper the restructuring process and place onerous restrictions on debtor licensors or potential purchasers. Furthermore, there is currently no definition of "use" and this term is used in different contexts with reference to IP.

A definition of "use" which references the exploitation of licensed IP will, at the very least, reduce uncertainty and the accompanying litigation associated with a lack of clarity towards what can and cannot be done with IP.

The following questions are thus worthy of further reflection and consideration:

- Should licensees be able to exploit IP in accordance with the terms of their license?

- How should situations where a licensee has access to IP but is not "using" it *per se* be addressed?

- Should the meaning of "use" be defined in relation to the rights granted in the underlying license?

In each instance, the affected rights should be considered from both the licensee and licensor perspective in an attempt to develop the most appropriate and equitable balance between the parties.

[9] See section 365(m) of the *US Bankruptcy Code*.

[10] See section 32(6) CCAA and 65.11(7) BIA.

3.1.5 IP rights of licensors upon the insolvency of a licensee

The JTF believes that the treatment of licensors of IP rights upon the insolvency of licensees is also an issue worthy of consideration.

Under existing provisions, the court may order an assignment of the license provided, *inter alia*, that the assignee will be able to perform the assigned obligations and, more broadly, provided that it is appropriate to allow such assignment[11].

Currently, IP license agreements may be subject to a forced assignment under the BIA and CCAA such that the consent of the licensor is no longer required. Accordingly, licenses may be assigned to competitors of licensors or others who may for valid reasons be objectionable for the licensor on an ongoing basis.

The following questions are thus worthy of further reflection and consideration:

- What is the appropriate balance to strike in this circumstance?
- What factors should the court consider in exercising its discretion to approve the assignment of IP over the objections of the licensor?
- Should good faith be a consideration in approving sales and/or transfers of licenses?

In each instance, the affected rights should be considered from both the licensee and licensor perspective in an attempt to promote a balance between protecting IP rights and maximizing value in the estate through the insolvency process.

3.1.6 Formal protection of trade-marks.

The JTF believes that the protection of trade-marks in the context of insolvency is an issue worthy of consideration. The exclusion of trade-marks protection in the *US Bankruptcy Code* has been the object of controversy in the US and further research in this regard is warranted to determine whether or not trade-marks should benefit from protection similar to that afforded to other types of IP.

3.1.7 “Patent-trolls” and IP litigation in insolvency proceedings

There is currently no statutory obligation to act in good faith under the BIA or the CCAA. This allows for licensors and licensees to take positions during the bargaining process that they know have little merit but may provide them with a temporary advantage in the marketplace or leverage in the insolvency process.

In the US, concerns have been raided about “Patent-trolls” who purchase patents and other IP rights in insolvencies or otherwise for the purpose of pursuing litigation against parties who may have had dealings in the past with the debtor or who may allegedly be using the debtor’s IP. A similar concern can be raised in Canada and if so, consideration has to be given as to whether this is IP law issue generally or whether it is a problem that may arise specifically in an insolvency context and thus requires an insolvency solution.

[11] See Sections 84.1 and 66 BIA and 11.3 CCAA.

Some additional concerns and questions which might be considered in this regard include:

- In the IP context, should concerns be addressed or reviewed under a good-faith or public policy consideration when the court is being asked to approve the sale of IP assets?

- What obligations should trustees and monitors have to investigate and assess motives or *bona fide* of potential purchasers?

- Should the insolvency courts consider and assess any intentions or motives of IP purchasers?

3.1.8 Cross-border IP and intermingled IP during an insolvency proceeding.

The treatment of cross-border rights in the context of the restructuring of corporate group enterprises is, in the JTF's view, an issue worthy of consideration.

When corporate group enterprises face insolvency, there are regularly issues as to the treatment of cross-border IP rights. Many issues of this nature have arisen in the context of the liquidation of the Nortel IP rights for instance.

Sometimes, IP is owned by one entity in one jurisdiction but used in multiple jurisdictions. There should be a level of consistency in these circumstances and Canadian legislation should strive to deal with IP in a manner that is compatible with the treatment of IP in other major jurisdictions. Furthermore, IP may be co-owned by multiple entities as it may have been developed using the resources of more than one party (i.e. in joint ventures).

The following questions are thus worthy of further consideration and reflection:

- How should IP rights be treated when IP is located globally or in more than one jurisdiction?

- What law should govern the treatment of IP in those scenarios and should there be legislative guidance to deal with those situations?

- How should IP be dealt with if it is subject to a complex web of ownership whereby different parties have made varying contributions to its creation?

Different types of IP will require different treatment and considerations. Some form of IP such as patents and trademarks are inherently easier to protect since they are registered to a legal owner in a specific jurisdiction. In those circumstances, it may make sense for the law of the jurisdiction where the IP is registered to govern.

Consideration should also be given to what extent it may be appropriate for there to be harmony between the treatment of IP in Canada and the treatment of IP in other jurisdictions such as the United States and England. Coordination in this regard with other jurisdictions may reduce costs and uncertainty and provide greater incentives for innovation and creativity with respect to IP.

3.2 Streamlining CCAA proceedings and Initial Orders

IC has requested submissions regarding the breadth of Initial Orders and potential options for streamlining the process.

JTF Comments

The JTF is of the view that eventual legislative reform of CCAA should be mindful of measures to be adopted to increase the efficiency and reduce the costs involved in the restructuring process. In Canada and in other jurisdictions[12], it has indeed become evident that restructuring costs have become a source of preoccupation for creditors, debtor companies, practitioners and stakeholders in general.

The JTF believes that some research should be made to assess whether the current preoccupation of creditors, debtor companies, practitioners and stakeholders regarding excessive costs is a matter of real concern or of perception. Some have argued that restructuring costs, which are essentially transactional costs, are no higher and may even be lower than similar costs incurred in other transactional activities in the marketplace. They may appear to be higher because they are perceived to remove returns from creditors' claims rather than enhance value for stakeholders as a whole by preserving a going concern.[13] The practical principle-based approach and role of the monitor as court officer embodied in the CCAA statute does serve to facilitate what is generally a more efficient, less litigious and less costly restructuring process in Canada than in other jurisdictions such as the United States. Further, a number of initiatives have been put into practice by the restructuring profession with the objective of streamlining the CCAA process and keeping costs down. However, the JTF agrees that efforts have to continue to be made to improve efficiency and cost-effectiveness.

The suggestion made that initial order mechanisms under the CCAA provide for a short automatic stay period as well as limited "lights on" protection of the debtor company is worthy of consideration. Such automatic limited protection, similar to that resulting from the filing of a notice of intent to file a proposal under the BIA could reduce litigation and costs related to the issuance of the initial order and increase the efficiency of the CCAA process.

It should be borne in mind however that in all Canadian provinces, model initial orders have been adopted through the combined effort and collaboration between insolvency practitioners and the judiciary. Such model initial orders have been instrumental in improving the efficiency of the restructuring process and the stakeholders' ability to foresee the protection mechanisms usually made available to a debtor company seeking to restructure under the CCAA. Such model initial orders generally contain a "comeback" clause pursuant to which interested stakeholders may address the court within a certain delay to seek to have the terms of the initial order modified or rescinded.

The JTF is of the view that restricting the breadth of initial order to "lights on" protection of the debtor company, limited both in scope and in time, could serve to postpone "out of the gate" litigation as to the breadth of the initial order sought by the debtor company. This

[12] For example, in the US, in 2013, the Executive Office for United States Trustees adopted "*Guidelines for Reviewing Applications for compensation and reimbursement of expenses filed under United States Code by Attorneys in Larger Chapter 11 Cases*" (see Federal Register, Vol. 78, No. 116, June 17, 2013.

[13] A "Cost"-Benefit Analysis: Examining Professional Fees in CCAA Proceedings, by Stephanie Ben Ishai and Virginia Torrie in 2009 Annual Review of Insolvency Law (Janis P. Sarra, ed.) Thomson Reuters Canada Limited. The authors quote studies by Stephen Lubben in the U.S.

approach would afford stakeholders necessary time to seek to resolve these issues through negotiations. This being said, limited automatic "lights on" protection should not unduly modify present practice in respect to the use of model initial orders which provide necessary flexibility as to the required degree of protection based upon the circumstances of each case, particularly in the most vulnerable situations where greater clarity to stakeholders and affected parties at the outset may be critically important.

3.3 Claims Process

IC has requested submissions regarding the existing claims process and whether consideration should be given to a default process.

JTF Comments

The JTF believes that the reduction of costs associated with a claims process in a CCAA restructuring is an objective worthy of consideration in the next round of legislative reform. However, reform in this regard should not unduly restrict the flexibility of existing practice in CCAA restructurings to adapt the court approved claims process to the specific factual context at hand.

In certain circumstances, namely where the books and records of the debtor company are not accurate or otherwise reliable, a default mechanism for determining claims may not be appropriate. Reform should thus encourage cost effective claims processes while preserving the flexibility and discretion of the courts given the varying factual circumstances of each CCAA restructuring.

The JTF also notes that there is no clear rationale to justify existing differences between the treatment of claims in a BIA restructuring and the treatment of claims in a CCAA restructuring. It may thus be relevant to consider adopting or, *inter alia*, model proof of claim in CCAA similar to the model generally used under the BIA.[14]

3.4 Court Applications

IC has requested submissions regarding the existing role of court appearances in CCAA proceedings and whether considerations should be given to possible approaches to reduce the number and cost of such court appearances.

JTF Comments

As previously mentioned, the JTF supports that legislative changes be considered to improve the efficiency and cost effectiveness of the CCAA restructuring process and necessary court appearances related thereto.

Measures to be considered in this regard include the following:

- implementing initial order mechanisms which provide for a short automatic stay period and "lights on" protection of the debtor company[15];

[14] See form 31 BIA.

[15] See Section 3.2 hereinabove.

- providing that renewal of CCAA protection be granted automatically where due prior notice has been given to creditors and relevant stakeholders and no objection has been filed;
- increasing attendance at hearings by phone, where appropriate, to avoid court costs associated with "watching briefs".

Balancing competing interests

3.5 Role of unsecured creditors

IC has requested submissions regarding the effectiveness of the existing provisions and other potential mechanisms to ensure the effective voice for unsecured creditors and restructuring proceedings.

JTF Comments

The JTF believes that the due and efficient representation of unsecured creditors in CCAA proceedings is an issue worthy of consideration.

The JTF cautions however that the creation of "unsecured creditors' committees" whose professionals are to be paid for by the debtor should remain exceptional and subject to broad judicial discretion dependent on the factual context of each case. It is generally perceived that the US practice of having the debtor pay for counsel and financial advisors mandated to protect the interests of unsecured creditors, may lead to unnecessary litigation, increased costs and inefficiencies. It must be borne in mind that in the context of CCAA proceedings, the monitor acts as a court officer and exercises a degree of supervision which is beneficial to the interests of unsecured creditors of a debtor company. The role played by the monitor (and the proposal trustee) in CCAA proceedings constitutes an essential difference between the US and the Canadian restructuring systems and justifies that unsecured creditors' committees remain an exception in CCAA proceedings.

The existing legislative scheme under BIA and CCAA whereby the court may provide that the fees of certain professionals will be covered by a prior ranking charge[16] provides adequate judicial discretion and authority in this respect.

3.6 Acting in Good Faith

IC has requested submissions regarding whether the CCAA should expressly address whether parties to the proceedings have a duty to act in good faith.

JTF Comments

As presently drafted, BIA and CCAA impose a duty to act in good faith upon the insolvent debtor[17], upon the trustee[18] and the monitor[19] but does not impose a broader duty to act in good faith upon all stakeholders involved in a restructuring process. It is perceived that

[16] See 11.52 CCAA and 64.2 BIA.

[17] Section 50.4(9) BIA and 11.02 CCAA.

[18] Section 50.4(5) BIA.

[19] Section 25 CCAA.

the codification of a duty to act in good faith could bolster the courts' authority to protect the integrity and efficiency of the insolvency system, without limiting the right of creditors to protect their own rights and interests in a restructuring process. While the JTF believes that the codification in the CCAA and in BIA of an overarching duty of stakeholders to act in good faith is worthy of consideration, eventual legislative reform should be mindful of not distorting common law or civil law principles or possibly creating fundamental divergences in the way BIA and CCAA process could be managed in Québec and in the rest of Canada. The JTF considers that additional research is warranted to assess differences existing between common law and civil law jurisdictions in this regard with a view to avoiding a legislative change that may result in creating undue legal uncertainty and differences in approach across Canada.

It should also be borne in mind that under CCAA, the court has very broad discretion to render any order it deems appropriate in the circumstances[20].. The CCAA court may thus adjudicate matters equitably without the formal codification of a duty of good faith.

3.7 Eligible Financial Contracts

IC has invited submissions regarding Eligible Financial Contracts and their impact on insolvency and restructuring proceedings, as well as potential policy responses.

JTF Comments

The JTF believes that the treatment of eligible financial contracts ("**EFCs**") in respect of an insolvent estate is worthy of consideration.

The Canadian insolvency regime protects EFCs by exempting them from the treatment that contracts ordinarily receive upon the commencement of insolvency proceedings. The core components of the EFC protection, commonly known as "safe harbours", primarily provide an exemption from the stay of proceedings, thus allowing the termination of EFCs by the solvent counterparty, the determination of a net amount owing under the terminated EFCs and the realization upon financial collateral posted in respect of EFCs. The EFC safe harbours also provide solvent counterparties with a higher priority to financial collateral posted in respect of EFCs. Further, the insolvent estate is forbidden from terminating or assigning EFCs upon its insolvency.

EFCs receive special protection to reduce systemic risks in Canadian and global financial markets where the failure of parties to EFCs on a large scale can create a chain reaction which can lead to a global liquidity crisis. The obligations under EFCs are often based upon substantial notional amounts and the value of the underlying reference items and of the financial collateral securing EFCs obligations can be highly volatile. In addition, the EFC safe harbours were introduced to ensure certainty in global financial markets and to provide Canadian institutions with access to the global derivatives markets and make them competitive in these markets.

The current treatment of EFCs under the Canadian insolvency regime does not always strike a right balance between the objectives of protecting against systemic risk and allowing insolvent commercial enterprises to restructure. Current law may in some cases impede the restructuring of insolvent enterprises and prevent the insolvent estate from realizing value for its

[20] See section 11 CCAA.

creditors by placing too much emphasis on attempting to reduce systemic risk. Further, the safe harbours may delay or prevent certain liabilities of the insolvent estate from being crystallized.

The JTF believes that changes are warranted to provide a better balance between the systemic risk reduction objective and the insolvency objectives, i.e. promoting restructuring of insolvent debtors with an opportunity for a fresh start, avoiding bankruptcy, preserving value and providing predictability of results.

The JTF believes that consideration should be given to implementing the recommendations made by IIC regarding the treatment of EFCs under Canadian insolvency law. The recommendations are mainly as follows:

- Allowing the insolvent estate to terminate EFCs after the expiry of an appropriate period during which the solvent counterparty has the unilateral right to terminate EFCs;

- Allowing the insolvent estate or the court to assign EFCs while permitting the solvent counterparty to terminate the EFCs until the assignment occurs;

- Prohibiting or rendering ineffective walk-away clauses that reduce amounts owed under EFCs because of an insolvency;

- Increasing the priority of financial collateral posted in respect of collateral which is segregated from the insolvent's other assets;

- Protecting the central clearing of over-the-counter derivatives; and

- Ensuring that the safe harbours apply consistently in receiverships.

The recommendations are set out and discussed in a detailed report prepared by the IIC's Derivatives Task Force. The report has previously been submitted by the IIC to Industry Canada and is attached as schedule B to this report.

3.8 Professional Fees in CCAA Proceedings

IC has requested submissions regarding the impact of professional fees on insolvency proceedings, including the utility of greater discloser practices.

JTF Comments

The JTF is of the view that professional fees and their impact upon the efficiency and cost-effectiveness of the Canadian insolvency regime are issues worthy of consideration. While there presently are no known reliable statistics in this regard and while the issue does not appear to have arisen in a significant number of Canadian restructurings, it is perceived that the high professional costs involved in CCAA restructurings may sometimes be a deterrent to efficient restructuring. Such potential negative impact of professional fees is a source of concern in other jurisdictions such as the United States, the United Kingdom and Australia and should also be a source of concern in Canada.

The JTF believes that further consultation and polling of the respective members of IIC and CAIRP and of other interested stakeholders such as secured lenders shall be essential to identify appropriate measures to reduce or otherwise monitor more efficiently professional fees incurred in CCAA proceedings. It should indeed be borne in mind that certain practical measures for the efficient management of professional fees may be implemented without being formally addressed under federal legislation.

Enhancing Transparency

3.9 Creditor Lists

IC has invited submissions regarding imposing an obligation on the debtor company to maintain a creditors' list during a CCAA proceeding.

JTF Comments

The JTF is of the view that codifying a debtor company's obligation to maintain and update a creditors' list during a CCAA proceeding is an issue worthy of consideration. Greater clarity and disclosure in this regard would allow other stakeholders to adequately organize and develop bargaining positions. Any legislative amendment in this regard should however be mindful of the costs to be incurred to maintain and update such creditors' list.

3.10 Empty Voting and Disclosure of Economic Interests

IC has invited submissions and input on whether courts should be empowered to require greater disclosure of creditors' actual economic interests or to take account of those interests.

JTF Comments

The JTF believes that, in a restructuring context, the disclosure of a stakeholder's true economic interests and related means to compel such disclosure is an issue worthy of consideration in an eventual reform of the BIA and CCAA. This issue was of significant concern in the ABCP restructuring under the CCAA, namely in respect of creditors benefiting from credit default swaps which necessarily affect such creditors' economic interest in the restructuring. The rationale for compelling a stakeholder to disclose all of its economic interests in a restructuring context is intrinsically related to the transparency of the process as a restructuring may be unduly impaired where creditors with undisclosed economic interests seek to profit from a failed restructuring process.

The means to be considered to achieve necessary disclosure of actual economic interests of stakeholders could include the following:

- granting the court necessary authority to compel the disclosure of all economic interests of a creditor;
- granting the monitor or trustee necessary authority to compel the disclosure of all economic interests of a creditor;
- consider use of a broader duty of good faith[21] which would be incumbent upon all stakeholders involved in a restructuring process.

[21] See « *Acting in Good Faith*» in section 3.6 hereinabove.

With respect to the potential impact of distressed debt trading, the JTF cautions that any inherent statutory limitations as to the assignability of claims against an insolvent debtor company may negatively affect the debt market and related secondary distressed debt market. As a general principle, creditors should be allowed to purchase and sell claims against an insolvent debtor (even for the admitted purpose of acquiring a majority or blocking position) and should be able to vote for the full amount of such claims even though they may have been purchased at a discount. Such general principle, which underpins the distressed debt market, should only be subject to limited exceptions, namely where it can be demonstrated that the creditor having purchased distressed debt is not acting in good faith or otherwise unduly seeking to impair the restructuring. Any legislative solution in this regard should preserve broad judicial discretion essential to the evaluation of the consequences on a case by case basis. Judicial intervention in a debt trading context has been justified, *inter alia*, by the general principle pursuant to which the powers conferred upon a majority of creditors must be exercised *bona fide* for the interests of the class of creditors and not for the benefit of individual interests[22].

Role of the monitor

3.11 Pre-filing reports

IC has requested submissions regarding whether pre-filing reports should be permitted and if so, in what circumstances.

JTF Comments

The JTF believes that use of pre-filing reports should be authorized in certain circumstances. In light of the fact that this issue has been dealt with unevenly by Canadian courts, (i.e. certain courts refuse to allow pre-filing reports while others have allowed same), the JTF concludes that this issue is worthy of consideration in the next round of legislative reform.

Legislative amendments with respect to pre-filing reports should be mindful of the following safeguards and protection:

- to allow pre-filing reports, the court should be satisfied, *inter alia*, that such reports have been prepared impartially and objectively by the prospective court-appointed monitor;

- when allowed, pre-filing reports should benefit from the same protection as that afforded to other reports prepared by the monitor under Section 23(2) CCAA.

3.12 Conflict of Interest

IC has requested submissions regarding whether additional measures are necessary to address the potential for conflicts of interest where a monitor has a pre-filing relationship as financial advisor to a debtor company.

JTF Comments

The JTF is of the view that significant checks and balances are already in place concerning the status, conduct and role of the monitor and, accordingly, the implementation of

[22] See *British America Nickel Corporation, Limited* vs. *MJ O'Brien*, [1927] AC 473.

additional protective measures to address potential conflicts of interest where the monitor has a pre-filing relationship with a debtor company is not worthy of consideration in the next round of legislative reform. Section 25 CCAA imposes broad duties upon the monitor to act honestly, in good faith and in accordance with the *BIA Code of Ethics*, which are meant, *inter alia*, to avoid monitors being placed in a conflict of interest position. Most monitors are also subject to CAIRP Guidelines in this regard.

Asset Sales

3.13 **Credit Bidding and Stalking Horse Bids**

IC has invited comments on whether credit bidding should be permitted and if so, what limitations may be appropriate.

IC has invited comment on whether stalking horse bids should be expressly permitted under Canadian insolvency legislation and, if so, what limitations may be appropriate.

JTF Comments

The JTF considers that reviewing and possibly expanding the scope of Sections 65.13 BIA and 36 CCAA to better deal with asset sales in general and more specific issues, including credit-bidding and stalking horse bids, is worthy of consideration.

The JTF believes that changes implemented in sale processes in the context of a restructuring exercise, if any, should be made with a view to retaining a high degree of harmony between the provisions of the CCAA and the equivalent provisions of the BIA.

Whenever judicial approval is sought, the BIA/CCAA should direct the court to consider a non-exhaustive set of criteria and provide for the filing of a report by the trustee or monitor. Such a report should disclose and analyse all circumstances which could materially affect the fairness and competitiveness of the proposed court supervised process.

The JTF is of the view that credit bidding is permissible at law in Canada subject to contractual restrictions, if any, and does not support introducing specific statutory authority to limit credit bidding, subject to the already existing general grant of jurisdiction under Section 11 CCAA and the court's discretion to approve a sale or disposition of assets outside the ordinary course of business, or when requested by the parties, to approve a sale transaction. Possible options to better deal with credit bidding include increased focus on the issue at the time of selecting and approving a court supervised sale process and imposing additional factors at the time of court approval if the proposed sale or disposition is to be made to a purchaser/creditor relying on a credit bid to acquire the assets. The JTF recommends and supports increased input of trustees and monitors at all stages of a court supervised sale process, including at the time of designing a sale process to ensure its fairness and competitiveness and avoid possible chilling effects posed by credit bidding.

Regarding sales of assets in general, the JTF notes that the current provisions of the BIA and CCAA direct that all sales outside the normal course of business be subject to approval of the court, regardless of the importance of the sale or value of the assets. The JTF believes that some thought should be given to allowing discretion to the professionals involved in monitoring the activities of an insolvent business, to avoid a requirement for an approval in a situation where the sale could be considered immaterial to the restructuring process, to increase efficiency by removing the necessity of a court involvement in a matter that the court would consider *de minimis*. The JTF is mindful however that such discretion should be framed so as to provide an objective standard regarding the value of a contemplated transaction, and to maintain a degree of protection for the claims of employees.[23]

Regarding stalking horse bidding processes, the JTF considers that this method of selling assets has its place in insolvency proceedings in Canada, although the JTF is not convinced there presently exists a need to frame the stalking horse bidding process in a legislative provision. The JTF believes that to date, the court has supervised the stalking horse bidding processes and has developed principles that sufficiently frame their continued use. The JTF is mindful that the stalking horse bidding process could be used to upset the free market equilibrium that can allow for a transaction to take place at fair market value, by creating a chilling effect for prospective buyers who are not the stalking horse bidder. However the JTF believes that this is also true of other methods of selling assets. The JTF is concerned that legislating a strict framework for stalking horse bidding processes might adversely impede the opportunities to sell assets at fair market value, and as a consequence the JTF believes that the current system of court supervision, with guidelines developed by jurisprudence, should remain for such sales. The JTF believes the use of stalking horse credit bidding processes should continue to be monitored, to ensure that the guidelines developed in jurisprudence, together with the court approval process required in virtue of Sections 65.13 BIA and 36 CCAA, continue to protect against the possibility of removing competitiveness in the process of seeking a purchaser for the assets of an insolvent business.

3.14 **Applicability of Asset Sale Test**

IC has invited comments on whether a materiality test is required to determine when assets sales will be subject to court approval.

JTF Comments

The JTF believes that the codification of a materiality test with respect to necessary court approval of sales made outside the ordinary course of business is an issue worthy of consideration.

The JTF notes however that in CCAA proceedings, a "materiality" threshold is usually introduced through the initial order which customarily allows the debtor company to proceed with sales under a certain amount without the necessity of court approval (subject however to monitor consent). The JTF also notes that in a court appointed receivership proceedings, there are typically provisions for the receiver to proceed with certain assets sale without formal court approval. The codification of a "materiality test" should not unduly restrict judicial discretion in this regard.

3.15 **CBCA Arrangements**

IC has requested input regarding the practice of CBCA arrangements involving insolvent companies.

[23] Section 65.13(8) BIA and section 36(7) CCAA. The JTF points out that section 36(7) CCAA contains an incorrect reference to sections 6(4) and 6(5) CCAA that should be corrected. The correct reference should be to sections 6(5) and 6(6) CCAA.

JTF Comments

The *Canada Business Corporations Act*[24] ("**CBCA**") was not originally intended to be used to restructure an insolvent enterprise. With time, a practice has evolved whereby the CBCA provisions dealing with arrangements, namely section 192 CBCA, have been used to restructure an insolvent entity, notwithstanding the apparent prohibition in section 192(3) CBCA. This practice has evolved from an interpretation of the provisions to mean that the relief in section 192 CBCA is available to a corporate group provided that at least one of the entities in a corporate group is not insolvent and that the corporation which emerges from the arrangement must not be insolvent.

The Discussion Paper correctly identifies the issues regarding the use of the CBCA provisions to restructure an insolvent enterprise, and the JTF fully agrees with the issues as framed in the Discussion Paper. The JTF considers that the issues regarding the use of the CBCA to restructure enterprises and the safeguards and protections that should be available in so doing, as the case may be, can lead to a highly polarized debate, with some parties believing that the statute should never be used in an insolvency context and others believing that it can be a very useful and efficient tool, subject however to the introduction of additional safeguards.

As such, the JTF believes that the use of the CBCA as a restructuring tool, and the safeguards and protections that may be appropriate in this context are worthy of additional debate and analysis.

3.16 A Streamlined Small Business Proposal Proceeding

IC has invited submissions regarding whether a simplified, less expensive proposal process for SME's would be warranted.

JTF comments

The JTF supports the implementation of a simplified restructuring process under the BIA designed to allow small and medium sized enterprises to restructure under a streamlined, less expensive process. The JTF believes that legislative amendments in this regard could be inspired by the existing simplified rules applicable under the BIA with respect to consumer proposals[25]. Such simplified rules could include deemed proposal acceptance and deemed ratification by the court where no creditors objections are filed and automatic revival[26] of proposals that are in default, for example.

The JTF however cautions that it would be advisable to conduct further research and data analysis to adequately identify the level of debt which would constitute the threshold for a small or medium seized enterprise to be eligible for restructuring under the simplified restructuring process. The JTF also notes that the simplified process could potentially lead to abuse by insolvent smaller enterprises if it provides, as is the case for consumer proposals, that refusal of the proposal by creditors does not lead to automatic bankruptcy.

[24] R.S.C. 1985, c. C-44, as amended.

[25] See sections 66.11 to 66.4 BIA.

[26] See section 66.31(6) BIA.

3.17 Division I Proposals Extension

IC has requested input on extending the time for filing a Division I proposal following the filing of a notice of intention to file a proposal.

JTF comments

The JTF believes that the potential extension of the 6 month time limit to file a BIA proposal following the filing of a notice of intention to file a proposal is an issue worthy of consideration in the next round of legislative reform.

Any reform in this respect should however be mindful that the BIA is meant to provide for a more rapid restructuring process and that most restructurings under the BIA are traditionally completed by the filing of a proposal within the existing 6 month time frame. The courts could thus be statutorily authorized to extend the 6 month delay in certain circumstances but the criteria to be met by the insolvent person to benefit from such extension should not be overly permissive as to encourage longer and more costly restructurings under the BIA.

3.18 Liquidating CCAA Proceedings

IC has requested input on whether the CCAA should be amended to codify protection for stakeholders and principles for the courts to consider in liquidating CCAA proceedings.

JTF comments

Canadian courts have increasingly allowed the use of the CCAA for the purpose of proceeding to the sale or liquidation of an insolvent debtor company. Such use of CCAA is essentially premised on the maximization of value for creditors where going concern sales are conducted under court supervision[27], outside of a receivership proceeding.

The JTF believes that the courts have developed adequate criteria to determine the circumstances in which the CCAA may be used to allow for the sale or liquidation of insolvent debtor companies. It is thus suggested that the CCAA should not be amended to disallow use of the CCAA to proceed to sales or liquidation, namely as court supervision sale process under the CCAA generally yield better results and more effective protection for stakeholders than if the assets were otherwise disposed of in a receivership context.

This being said, because of its origins as a restructuring tool, the CCAA is not presently drafted to address certain issues which necessarily arise in the context of the sale and distribution of proceeds of an insolvent business. The JTF is thus of the view that various amendments to the CCAA should be envisaged, namely to incorporate a scheme of distribution similar to that contained under the BIA[28] in order to provide greater clarity as to the order in which creditors are to be paid from the proceeds resulting from a sale or a liquidation conducted under the CCAA. The absence of such statutory scheme of distribution under the CCAA has led to significant controversy before the courts, namely in matters such as *Indalex*, *Grant Forest Products, Timminco* and *White Birch*.

[27] Recent examples include *Nortel Networks Corporation (Re)*, 2012 ONSC 1213 and *Aveos Fleet Performance Inc. (Arrangement of),* 2012 QCCS 6796.

[28] See Sections 136 to144 BIA.

Enhancing Equity

3.19 Employees' Claims

IC has requested submissions regarding whether, and how, Canada could enhance protection of employee claims in insolvency proceedings.

JTF Comments

The JTF believes that further study of the rights of employees in insolvency proceedings is worthy of consideration. Employees represent a vulnerable group of creditors that is wholly dependent on their employer as their principal, if not only source of income and this group has limited means to monitor its credit exposure and protect against financial losses. While the JTF believes it is important to create meaningful and adequate protection for the employees, the JTF is mindful that a proper balance needs to be achieved, to ensure that the granting of protection does not have a perverse effect and unintended consequences of triggering insolvencies or adversely impacting economic performance and overall levels of employment in Canada by restricting access to credit and funding to all companies.

The JTF is aware that when discussing the topic of protection of the claims of employees, the issues that are most often raised are the possibility of increasing the maximum amount for a claim made under section 81.3 or 81.4 BIA, the possibility of expanding the claim under section 81.3 and 81.4 BIA to cover severance or termination, treating the claims of employees as a separate class, introducing a protection for long term disability and other similar benefits, expanding the statutory security provided for in section 81.5 and 81.6 BIA to cover amounts due for special payments and actuarial deficits and enhancing the protection available to employees by way of an indemnity payable though the Wage Earner Protection Program ("**WEPP**") established under the provisions of the *Wage Earner Protection Program Act* ("**WEPPA**")[29]. These issues are addressed in greater detail hereunder.

- Increasing the maximum amount for a claim made under section 81.3 or 81.4 BIA:

  The JTF is concerned that an increase in the priority charge will have a negative impact on, *inter alia*, the availability of credit and the value of existing debt instruments. Any increase in the priority charges created upon a bankruptcy or receivership raises the very real risk that those who lend against a borrower's assets will increase the reserves taken against the borrowing base for all borrowers that are employers.

  As well, in view of the fact that the WEPP was put in place to indemnify employees against losses incurred as a result of the bankruptcy or receivership of an employer, and to advance to the employees the payments that they would be entitled to receive under sections 81.3 or 81.4 BIA, the JTF believes it is likely that the stakeholders would perceive an increase in the maximum claim amount as an indirect manner of introducing a super-priority claim for the Crown, without any real benefit to employees, unless the indemnity payable under the WEPP is increased commensurately. This comes from the fact that the amount of the indemnity available to employees under the WEPP is approximately $3,600,

[29] S.C. 2005, c. 47 and S.C. 2007, c. 36, as amended.

while the maximum claim under section 81.3 and 81.4 BIA is $2,000 (subject to the possibility of an additional $1,000 for expenses incurred by a travelling salesperson).

- Expanding the claim under section 81.3 and 81.4 BIA to cover severance or termination:

  The JTF does not see any fundamental problem with the principle of including severance or termination in the definition of wages, to ensure that claims for severance or termination can benefit from the statutory security contemplated in sections 81.3 or 81.4 of the BIA. The JTF points out that some rewording would then be required to remove the requirement that the claim be in respect of work performed or services rendered in the 6 months before receivership or bankruptcy…, but the problem is not conceptual.

  However, the JTF perceives some practical problems with the suggestion that severance or termination be included in the priority under section 81.3 or 81.4 BIA. To the extent that the expansion of the priority claim is accomplished by increasing the statutory security cap of $2,000 referred to in sections 81,3 and 81.4 BIA, the issue is the same as that described hereinabove in the discussion of a possible increase of a maximum amount of a claim. The concern in this situation is that the increased statutory secured claim could affect access to credit, which may trigger additional insolvencies of employers. The JTF points out that in the past, when a suggestion was made to expand the claim under section 81.3 and 81.4 BIA to cover severance or termination, the legislative provisions drafted in connection with the proposed change did not include any maximum amount in respect of this aspect of the employees' claim[30]. In separate submissions made by CAIRP and the IIC in connection with the review of such proposed legislative changes[31], both CAIRP and IIC indicated their concern that the suggested legislative provisions may significantly curtail credit availability for employers, in view of the fact that the potential secured claim would be difficult or impossible to quantify. The potential impact on the reserves against the borrowing base calculations established by lenders to extend credit for such an un-quantified charge are significant, particularly if lenders take a conservative view of what the amount of the priority claim might be. The risk of increased reserves is significant as a result of the fact that the majority (approx. 62%) of the amounts paid to employees under the WEPP payments represent termination and severance pay, leaving a minority (38%) of the amounts paid on the WEPP actually subject to the subrogated claim.

  Furthermore, the JTF points out that since the calculation of severance and termination can vary widely from one province to another, and whether the

[30] Examples of such legislative provisions are found in Bills C-476, C-501 and S-214 (40th Parliament, 3rd session).

[31] The submissions were made in respect of Bills C-476, C-487, C-501, S-214 and S-216 (40th Parliament, 3rd session). CAIRP's submission is dated June 25, 2010 and can be found at www.cairp.ca/_files/file.php?fileid=filebcCsVntZzD&filename=file_CAIRP_commentary_on_proposed_new_legislation.pdf. IIC's submission is dated August 2010 and can be found at www.insolvency.ca/en/iicresources/resources/Pension_Reform_TF_Report_Final_2010.pdf.

calculation is made based solely on the statutory notice provisions found in labour standard legislation or based on a common law approach, the expansion of the protection to cover severance and termination could lead to inequitable results for individual employees, in the absence of a national standard to value the severance or termination claims.

Finally, the JTF believes that since at present, the employees are indemnified, at least in part, for the severance and termination claims through the WEPP, it is likely that the stakeholders would perceive an increase in the maximum claim amount as an indirect manner of introducing a super-priority claim for the Crown, without any real benefit to employees, unless the indemnity payable under the WEPP is increased commensurately. This issue is essentially the same as that described earlier herein, in the discussion of the possibility of increasing the maximum amount for a claim made under section 81.3 or 81.4 BIA.

- Treating the claims of employees as a separate class:

The JTF believes that this concept runs against the principles that have been developed with respect to the reasons to create fewer classes in a restructuring in order to increase the likelihood of success. Granting employees a separate class status may have the effect of extending an automatic veto to the employees on any restructuring plan. The employees are important stakeholders whose views must be taken into account in order to achieve a successful restructuring, as there is very little that an enterprise can accomplish without effective cooperation of its employees and their buy in to the enterprise's business strategy. However, the JTF believes it would be ill advised to give the employees, as a group, (or other groups of unsecured creditors such as trade suppliers for that matter) a right of veto, considering that this veto might be exercised inadvertently, without any intention of doing so, if the employees neglect to express a favorable vote on a proposal or abstain from voting. The BIA and CCAA require for a positive vote in order for a proposal or plan to be accepted. This is particularly important in the context of a proposal under the BIA, since an abstention from the employee group would result in a deemed assignment in bankruptcy, as the BIA provides that the debtor becomes bankrupt if the proposal is not accepted by the required majority of creditors in each class of unsecured claims.

The JTF considers that the legislation presently allows sufficient flexibility for employees to be able to seek the benefit of a separate class in situations where they can show the court supervising the restructuring that they should be placed in a separate class using the same test that other creditors must meet.

- Introducing a protection for long term disability ("**LTD**") and other similar benefits:

The JTF believes that this issue stems primarily from the Nortel proceedings. New legislation has been created in response to the problem that surfaced in the Nortel file, to require federally regulated employers that offer LTD plans to have the plans carried by a third party insurer rather than self-funding.

Nortel appears to be somewhat anomalous – typically, LTD plans are not self-funded but are placed with a third party insurer.

The issue of a wide ranging new super-priority for amounts due to employees for LTD and other similar benefits was addressed in proposed new legislation[32] and both the IIC and CAIRP, in separate submissions, outlined a number of practical problems with this proposed legislation. The JTF believes the comments made by IIC and CAIRP through their submissions in 2010 are still relevant in this respect[33].

- Expanding the statutory security provided for in section 81.5 and 81.6 BIA to cover amounts due for special payments and actuarial deficits:

  The issue of a wide ranging new super-priority for amounts due to pension plans on account of special payments and for an eventual loss on liquidation or wind down of a plan as estimated by an actuarial deficit calculation, was addressed in proposed new legislation[34] and both the IIC and CAIRP, in separate submissions, outlined a number of practical problems with this proposed legislation. The JTF believes the comments made by IIC and CAIRP through their submissions in 2010 are still relevant in this respect[35].

  Perhaps most importantly, from a policy perspective, targeting pension treatment and/or priority by amending the BIA or CCAA is ineffective to achieve the objective of protecting pension rights of employees. Enhancing employee protection is better implemented via changes to the federal and/or provincial Pensions Act(s) to ensure that the majority of pensions (those whose employers/sponsors will not be subject to insolvency proceedings) are properly funded.

  The JTF also queries whether some method of mutualisation of the loss might be an appropriate way of providing added protection for amounts payable under a defined benefit plan in the event of insolvency, however the JTF believes this discussion may not be wholly relevant in the context of reform to the insolvency statutes. The JTF is convinced that IIC and CAIRP would welcome an opportunity to participate in discussions to alleviate the pension deficit problem in order to avoid insolvency related problems or minimize the impact of insolvency, if requested.

- Enhancing the protection available to employees by way of an indemnity payable though the WEPP:

  The JTF acknowledges that the current request for submissions does not address proposed changes to the WEPPA, as this legislation is subject to its own review process, separately from the one conducted by IC. However, there is such a large degree of interaction between the insolvency statutes and the WEPPA that some discussion is warranted. The JTF believes that the WEPP is a valuable program to protect employees when they lose employment as a result of their employers' bankruptcy or receivership, although the JTF believes the program should be reviewed, expanded and improved, as some flaws and

[32] See note 30.

[33] See note 31.

[34] See note 30.

[35] See note 31.

weaknesses have been noted in its application. The more fundamental issues that the JTF believes should be addressed at this time are the following:

- The WEPP is costly to administer and the processing fees of the trustee/receiver are not covered by those who benefit. As a result, the program causes some inequity for stakeholders, such as secured or unsecured creditors, by allocating some of the resources that would otherwise be available to pay dividends to the administration of the WEPP. To be clear, the JTF is not suggesting that the costs to administer the WEPP should be deducted from the employees' entitlement, as this would be counterproductive to the objectives of the program itself. The JTF considers that to the extent that the program is an indemnity program set up by the government, its costs should be borne by the program.

- Some improvement could be made to make the program more efficient. The JTF notes that one of the objectives of the WEPP is to accelerate payment ot employees in connection with the amounts they would be entitled to receive under section 81.3 and 81.4 BIA, while it may in fact take a significant period of time before the indemnities are paid to displaced employees.

- Employees who work for a receiver may have their claim relating to severance or termination affected by continuing employment to assist the receiver in winding down the business.

- There appears to be an inequity that creeps in the program when there is an interaction between the provisions of the *Employment Insurance Act*[36] and the WEPPA. More specifically, it appears that employees that are entitled to EI benefits may see these benefits curtailed as a result of the benefits paid under WEPPA. No equivalent loss of benefit is experienced by en employee who immediately finds other employment.

- The current provisions of the WEPPA create some uncertainty in the application of the provisions, when there is a concurrent bankruptcy and receivership.

- The system for reporting information for purposes of the program can be inefficient, as it can only accommodate a manual record-by-by record entry of data.

- Some of the provisions of the WEPPA and of the BIA that refer to the same concept are misaligned, which may result in a loss of benefit for affected employees.

- And most importantly, the WEPP is only available in situations where the employer is bankrupt or in receivership, and, as a result, does not allow

[36] S.C. 1996, c. 23, as amended.

> any protection for employees who are displaced as a result of the insolvency of their employers, if the restructuring process is successful[37].

In short, the JTF believes that additional thought needs to be given to protection of the claims that are customarily referred to as employee claims, which would include claims of former employees for severance and termination and claims of pension plans. However the JTF believes that in addressing possible changes, a comprehensive consultation process be undertaken to assess the possible impact of the added protection if the added protection results in additional statutorily secured charges against the assets of an insolvent company. The JTF is concerned that any additional charge could affect the access to capital and thus precipitate insolvencies of employers who might otherwise have a viable enterprise.

Finally, the JTF believes it would be remiss if it did not comment on the changes implemented in the 2009 Amendments which specify that, while a court may in certain circumstances order that the parties enter into a renegotiation of a collective bargaining agreement, the court may not compel a termination, change or suspension of the provisions of the collective bargaining agreement[38]. The JTF believes there is some risk that this provision may, in certain circumstances, hinder the presentation of a viable proposal or plan. However, the JTF acknowledges that the legislator has decided to trust the collective goodwill of employees and employers to come up with a solution that will avoid a loss of employment. While the JTF believes that in certain cases the slow pace of collective bargaining negotiations could put a restructuring process at risk, the JTF is not aware of any situation where a viable plan was possible but was thwarted as a result of the currently existing provisions. As such the JTF considers that the provision should not be changed, but should continue to be closely monitored.

3.20 Employees Claims in Asset Sales

Stakeholders are invited to make submissions whether the existing provisions adequately protect the employees' claims.

JTF Comments

The JTF is of the view that adequate protection of employees' claims where sales are conducted under the CCAA or BIA is an issue worthy of consideration in the next round of legislative reform.

The JTF is not however aware of instances where sales conducted under the CCAA[39] or BIA[40] were authorized by the court to the detriment or prejudice of employees' claims for wages or normal cost contributions owed to a pension plan. Perhaps this is because both the CCAA[41] and BIA[42] expressly provide that the court may only authorize a sale conducted outside the

[37] See Jean-Daniel Breton, *Employee protection in insolvency proceedings – Reviewing the performance and setting the objectives*, in 2010 Annual Review of Insolvency Law (Janis P. Sarra, ed.) and WEPPA – *What ails it and can it be fixed?*, in 2012 Annual Review of Insolvency Law (Janis P. Sarra, ed.), Thompson Reuters Canada Limited.

[38] See section 33 CCAA and 65.12 BIA.

[39] Section 36 CCAA.

[40] Section 65.13 BIA.

[41] Section 36(7) CCAA.

[42] Section 65.(8) BIA.

ordinary course of business if it is satisfied that such payments can and will be made to employees.

The JTF also notes that it may be difficult to codify a “materiality test” in respect of the sales conducted under the CCAA or BIA which justify court authorization. Under the CCAA, the initial order customarily contains clauses setting out the maximum value of sales which may be conducted by the debtor company without the need for judicial authorization.

3.21 Hardship Funds

IC has requested submissions regarding whether express authorization for interim dividends in certain circumstances is required and, if so, any potential limitations on the court's discretion.

JTF Comments

The JTF does not believe that it is essential to codify a CCAA court's authority to authorize the payment of interim dividends in certain circumstances, as is otherwise provided under the BIA[43].

In this regard, the JTF concludes that the broad discretion conferred upon the court under section 11 CCAA constitutes sufficient statutory authority to allow the court to allow for the payment of interim dividends to creditors where circumstances justify same.

3.22 Third Party Releases

IC has invited submissions regarding whether the Third Party Releases are appropriate and, if so, whether the identified criteria are sufficient to prevent potential abuse.

JTF Comments

The JTF believes that the criteria developed by the courts[44] to authorize the implementation of a plan of arrangement filed under the CCAA which includes releases against third parties (i.e. parties other than the debtor or a director of the debtor) are satisfactory.

Because of the fact that the courts' capacity to authorize third party releases in the context of the implementation of a CCAA plan results from broad judicial discretion under the CCAA, it is uncertain as to whether such third party releases may be granted by the court in the context of the ratification of a proposal filed under the BIA. The JTF believes that the court's authority to allow the release of third parties who have made a reasonable contribution to a creditor approved proposal or plan of arrangement is an important restructuring tool which should be available both under the CCAA and BIA. There is no satisfactory rationale for allowing third party releases in certain circumstances under the CCAA and not under the BIA.

The JTF is also of the view that potential codification of the existing criteria developed by the courts to allow third party releases is worthy of consideration. Any codification in this regard should however be mindful of preserving judicial flexibility and judicial discretion.

[43] See Section 136(2) and 148(1) BIA.

[44] See *Metcalfe and Mansfield Alternative Investments II Corp., (Re)*, 2008 ONCA 587.

3.23 Key Employee Retention Bonuses

IC has requested submissions regarding whether employee bonuses should be permitted in an insolvency proceeding and, if so, whether terms and conditions should be codified.

IC has also requested submissions regarding whether director and officer liability could be imposed for bonus programs created during an insolvency proceeding.

JTF Comments

The JTF is of the view that, in certain circumstances, Key Employee Retention Bonuses or Key Employee Retention Plans ("**KERB**" or "**KERP**") should be authorized by the courts in order to ensure that going concern operations are maintained and valuable employees are retained during the restructuring process.

Potential codification of the courts authority to allow the payment of employee retention bonuses should take into consideration the following:

- existing criteria developed by the courts to allow for the payment of KERBs;
- necessary monitor approval of the proposed payment of KERBs;
- due prior notice to likely affected creditors of the proposed KERBs;
- the need for disclosure to affected creditors of the terms of the proposed KERBs.

The JTF also feels that any potential legislative reform in respect to KERBs should involve further study and analysis of the status of US law in this regard, insofar as this issue is statutorily addressed in the United States.[45]

3.24 Oppression remedy

IC has requested submissions regarding whether restrictions on the availability of the oppression remedy should be imposed in the insolvency context.

JTF Comments

The JTF is of the view that it is not necessary to consider legislative amendments to CCAA or BIA in order to address issues relating to the availability of the oppression remedy in a context of insolvency proceedings. There does not appear to be sufficient evidence of improper use of the oppression remedy in context of insolvency proceedings to justify a legislated solution. Furthermore, the broad discretion otherwise available to the courts should be sufficient to adequately resolve issues of this nature. It should also be noted that potential amendments to impose an overarching "good faith" obligation upon stakeholders participating in a restructuring[46] may bolster judicial discretion in this regard.

[45] *Bankruptcy Code* 11 USC, Section 503(c).

[46] See above « Acting in good faith », in section 3.6 hereinabove.

3.25 Interest Claims

IC has requested submissions regarding the existing rules regarding interest claims.

JTF Comments

The JTF believes that the treatment of post-filing interest claims in the context of CCAA proceedings is an issue worthy of consideration in the context of eventual reform. More broadly, this issue also encompasses various types of post-filing debts which may be the object of claims in the context of restructuring proceedings, namely for the payment of yield maintenance penalties, make whole payments, prepayment premiums, default interest rates and other similar types of charges. Any legislative amendments in this regard should be mindful of the potential impact thereof upon the distressed debt and venture capital markets where debt instruments frequently contain such types of penalties and premiums.

The JTF believes that the treatment of post-filing interest claims should also be analyzed in the context of the BIA, to avoid situations where the relative claims of the creditors may change solely as a result of a change of proceedings from one restructuring statute to the other (CCAA vs. BIA), or from a change in status during the pendency of a restructuring proceeding (restructuring vs. bankruptcy).

3.26 Unpaid Suppliers

IC has invited submissions regarding the treatment of supplier claims for goods delivered in the period immediately *prior to insolvency proceedings.*

JTF Comments

The JTF is of the view that the limited protection afforded to unpaid suppliers at Section 81.1 BIA should be repealed. In this regard, the JTF shares the views and comments expressed by the Standing Senate Committee on Banking, Trade and Commerce in its November 2003 report[47]. The rationale for repealing Section 81.1 may be essentially summarized as follows:

- The protection is largely ineffective at protecting unpaid suppliers, and provides little more than an illusory right of recovery, due to the requirement that the merchandise be still unsold and identifiable at the time the claim is made, and the requirement that the debtor be bankrupt or in receivership;

- In view of the fact that the right can only be exercised when the debtor is bankrupt or in receivership, the legislative provision may be counterproductive to promoting restructuring and compromises, as it may force the creditors to make decisions aimed at maximizing individual recovery rather than maximizing value for all stakeholders;

- Even though the protection is largely ineffective, it adversely affects the availability of credit, as secured creditors who provide operating credit based

[47] *Debtors and creditors sharing the burden : A review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act : Report of the Standing Senate Committee on Banking, Trade and Commerce*, (November 2003), www.Senate-Senat.ca/Bancom.asp, pp. 105-111.

upon margin calculations and asset based lenders tend to curtail availability of funds based on a theoretical maximum claim by unpaid suppliers of "30 day goods".

- The provision is essentially unfair as it seeks to protect one class of creditors, the suppliers of goods, without providing an equivalent protection to similarly situated creditors such as the suppliers of services, in a context where there is no known policy rationale for providing this protection to one group and not the other.

This being said, the JTF believes that more limited supplier protection could be introduced by granting unpaid suppliers of goods and services limited protection as preferred creditors under section 136 BIA for very recent supplies of goods and services (with the appropriate period to be determined), without a need for specific identification.

While this issue is not directly addressed in the Discussion paper, the JTF also believes that the treatment of post-filing suppliers in a context of restructuring is worthy of consideration. Canadian insolvency statutes do not include provisions similar to those found in *US Bankruptcy Code* pursuant to which post-filing creditors benefit from a priority status as administrative claims[48]. Hence, at present, under Canadian law, post-filing creditors and suppliers are treated as unsecured creditors should the restructuring process under either the BIA or CCAA be interrupted. It should thus be considered to afford some degree of protection for post-filing creditors, by allowing a higher priority status to the claims of creditors who have supported the debtor through a restructuring attempt by providing credit, as compared with the claims of pre-commencement creditors.

3.27 Fruit and Vegetables Suppliers

IC has requested submissions regarding the existing farmers' superpriority in section 81.2 of the BIA.

JTF Comments

The JTF is of the view that the adequate protection of suppliers of farming, fishing or agricultural products is an issue worthy of consideration in the context of eventual reform.

The potential amendment of Section 81.2 BIA to expand the superpriority to products delivered within 30 days of a bankruptcy or the appointment of a receiver should however take into consideration the potential negative impact on the credit market as such expansion would limit access to credit where financed inventory includes inventory relating to farming, fishing or agricultural products.

Deterring Fraud and Abuse

3.28 Directors' disqualification

IC has requested submissions regarding whether directors of a corporation that has become subject to insolvency proceedings should be disqualified from acting as a director due to misconduct.

[48] *US Bankruptcy Code*, section 503(b)(9).

JTF Comments

The JTF is of the view that the issue as to whether directors of an insolvent corporation should be broadly disqualified from acting as directors should be addressed under the CBCA, not under the BIA or CCAA. An individual's capacity to act as director of a Canadian corporation is an issue of corporate governance which exceeds the scope of insolvency statutes.

It should also be borne in mind that the BIA[49] and CCAA[50] were amended in 2009 to grant to the court statutory authority to remove the director of an insolvent debtor where the court is satisfied that such director is unreasonably impairing or is likely to impair the possibility of a viable compromise or proposal.

3.29 Related Party Subordination and Set-off

IC has requested input as to whether debts of related parties should be allowed to be subordinated and whether set-off among related parties should be expressly prohibited.

JTF Comments

The JTF is of the view that legislative amendments to provide that debts among related parties are, *ipso facto*, subordinated would raise significant problems and could lead to inequitable results. Existing provisions of the BIA and CCAA already provide for the subordination of the claims of silent partners[51] and of creditors holding "equity claims"[52]. It is feared that broader court authority to subordinate the debts of parties related to the insolvent debtor or the *ipso facto* subordination of the debts of related parties could lead to judicial controversy similar to that prevalent in the United States in respect to the "re-characterization of debt" in a context of insolvency.

It is thus suggested that the nature and rank of the claims of related parties continue to be governed by existing provisions of the BIA and CCAA.

With respect to the issue of prohibiting set-off of debts among related parties, the JTF is of the view that this issue is worthy of consideration as part of a broader review of set-off mechanisms under the BIA and CCAA. This being said, insofar as the nature of the respective claims of related parties would necessarily vary depending on the factual circumstances of each case, there appears to be no clear rationale for broadly disallowing set-off as between the claims of related parties.

Cross-border Insolvencies

3.30 Foreign Claims under "Long-Arm" Legislation

IC has requested submissions regarding an appropriate response to Long Arm legislation.

[49] See Section 64 BIA.

[50] See Section 11.5 CCAA.

[51] See 139 BIA.

[52] See 140.1 BIA and 6(8) CCAA.

JTF Comments

The JTF believes that denying "long arm" claims based upon foreign legislation is an issue worthy of consideration, namely as long arm legislation seeks to adversely affect distribution to Canadian stakeholders of the proceeds of assets held by Canadian corporations.

The JTF notes however that denying the enforceability of "long arm" claims in Canada while adopting similar long arm legislation in Canada appears inconsistent.

The JTF further notes that a broader consideration of the enforceability in Canada of foreign law based claims (such as, for example, avoidance actions under Chapter 11 proceedings and ERISA[53] claims) may be warranted.

3.31 **Set-off for claims in multiple jurisdictions**

IC has requested submissions regarding the set-off of interest claims from another jurisdiction against principal.

JTF Comments

The JTF believes that this issue is not worthy of further consideration. This is a very particular issue that is seldom, if at all, subject to litigation. Most often, it is dealt with inside of a CCAA plan and the flexibility of dealing with such issues should be maintained rather than put at risk by any legislated restrictions or requirements on how such matters can be dealt with.

3.32 **Allocation of Proceeds**

IC has invited submissions regarding access to, and conveyance and allocation of, assets in cross-border insolvencies.

JTF Comments

The JTF is of the view that the question of whether and, if so, under what conditions Canadian courts can permit a substantive consolidation of foreign assets subject to a foreign proceeding with Canadian assets subject to a Canadian proceeding is worthy of consideration.

Whether and, if so, under what conditions a sale of assets located in Canada as part of a foreign proceeding should be permitted is also worthy of consideration.

3.33 **Treatment of Enterprise Groups**

IC has requested input regarding the treatment of enterprise groups in insolvency.

JTF Comments

The JTF believes that, with respect to the treatment of enterprise groups in insolvency, the avenue of enquiry and analyses should be reframed. Whether and, if so, on what conditions corporate groups filings should be permitted in Canada is worthy of consideration. In other

[53] *Employee Retirement Income Security Act*, found at *U.S. Code*, Title 29, chapter 18.

words, it is relevant to determine on what basis, if any, Canadian insolvency laws should permit making foreign subsidiaries direct applicants in a Canadian proceeding.

3.34 **"Center of Main Interests"**

IC has requested submissions regarding the need for procedural protections in cross-border recognition matters.

JTF Comments

The JTF is of the view that issues related to the identification of the proper center of main interests ("**COMI**") of a debtor company should be left to the judicial discretion of the judge overseeing the restructuring, with reference to the UNCITRAL guidelines. It may thus not be necessary to adopt specific amendments under which courts would be instructed to ensure that creditors have been given sufficient disclosure with respect to the identification of the COMI of a debtor company.

3.35 **Unsecured Creditors' Committees**

IC has requested input as to whether it is appropriate to develop principles and criteria for the recognition of foreign UCCs and to define the scope of UCC participation in Canadian insolvency proceedings.

JTF Comments

Given the role of the monitor in Canadian restructuring proceedings led under the CCAA, the JTF believes that it may not be necessary to consider specific amendments to define the scope of foreign unsecured creditors' committees in insolvency.

This said, more broadly, the JTF believes that it would be valuable to have some clear legislative guidelines to address whether or not the filing of a claim or otherwise appearing in Canadian restructuring proceedings constitutes attorning to the Canadian court's jurisdiction for any matters related to the restructuring being supervised by the Canadian court.

Administrative Issues

3.36 **Renaming the *Bankruptcy and Insolvency Act***

IC has requested submissions regarding the potential social stigma associated with "bankruptcy" and whether Canadians may be better served if that term is downplayed in the legislation.

JTF Comments

The JTF notes that the term "bankruptcy" is used in numerous jurisdictions to refer to legislation in respect to insolvency and is generally perceived to refer to the liquidation of the assets of a person who cannot meet his or her obligations as and when they become due. Conversely, the term "bankrupt" refers to the legal status of a person whose assets are liquidated for the benefit of his or her creditors.

While there is social stigma associated with the term “bankrupt”, the JTF believes that this issue has greater implications for practitioners in the field of consumer insolvency rather than corporate insolvency. However, the JTF perceives that the term “bankruptcy” creates some confusion in public perception where the BIA is used for restructuring purposes (as opposed to liquidation). The media often report that a company or individual has been placed under “bankruptcy protection” thus creating confusion as to whether or not the assets of such company or individual are being liquidated. This topic is addressed in greater detail in the submission by CAIRP related to consumer insolvency.

A Unified Insolvency Law

3.37 Merger of the BIA and CCAA

IC has requested submissions regarding a unified insolvency statute.

JTF Comments

The JTF does not believe that it is essential that the BIA and CCAA be merged into a single act. Both statutes were effectively harmonized by the 2009 Amendments and, while it may seem peculiar to have a two-tier statutory restructuring regime, the co-existence of the BIA and CCAA has not led to unfavourable results nor inequity.

As mentioned hereinabove[54], the JTF however notes that where the CCAA is used to proceed to the sale of a debtor company’s assets and undertakings, legislated changes to the CCAA could be envisaged to provide for the eventual bankruptcy of the debtor company once all of its assets and undertakings have been sold or otherwise liquidated. In effect, legislated change in this regard could seek to implement a “bridge to the BIA”[55] to allow the monitor necessary authority to transition to the bankruptcy of a debtor company having completed the liquidation of its assets under the CCAA.

3.38 *Winding-up and Restructuring Act*

JTF Comments

With respect to the *Winding-Up and Restructuring Act* (“**WURA**”)[56], the JTF believes that limiting the scope of WURA to financial institutions only is an issue worthy of consideration. In its report dated June 14, 2000 entitled *“The Winding-Up and Restructuring Act: Recommendations for Reform*”, the IIC made various suggestions regarding potential reform of WURA which include, *inter alia*, limiting its scope to financial institutions.

3.39 *Canada Transportation Act*

JTF Comments

With respect to the provisions of the *Canada Transportation Act* [57] which relate to schemes of arrangement to be made by insolvent railway companies, the JTF is of the view that

[54] See *Liquidating CCAA Proceedings, section 3.18* hereinabove.

[55] See *Century Services Inc. v. Canada (General Attorney)*, 2010 CSC 60.

[56] RSC 1985, c. W-11, as amended.

[57] SC 1996, c. 10.

there is no evident rationale for submitting railway companies to a different liquidation or restructuring regime than that which are set out in the BIA and CCAA. It may thus be worthy to consider necessary amendments to provide that railway companies be included in the respective definitions of "person" and "debtor company" under the BIA and CCAA to effectively provide that railway companies are subject to restructuring (or liquidation) under these statutes.

3.40 Restricting Consumer Proposals

IC has requested submissions as to whether the consumer proposal process should be amended to ensure that it is not used with respect to business debt.

JTF Comments

The JTF is unaware of instances where the use of consumer proposal mechanisms set out in the BIA in connection with commercial debts of a very small business has resulted in an unfair treatment for the creditors. The $250,000 threshold for consumer proposals makes it such that the amount of business debts subject to consumer proposals remains reasonable, on a relative scale. In the absence of evidence of abuse in the use of consumer proposals to settle business debts, the JTF does not believe that amendments should be contemplated to the consumer proposal provisions of the BIA in this regard.

3.41 Special Purpose Entities

IC has requested input on whether to expand the application of the BIA and CCAA to trusts used as special purpose entities.

JTF Comments

The JTF is of the view that the expansion of the term "person" (as used in the BIA) and "debtor company" (as used in the CCAA) to allow other types of business entities to be subject to proceedings under BIA or CCAA is an issue worthy of consideration.

Such expansion should not only cover trusts used as special purpose entities but all trusts used for business purposes[58]. Moreover, the somewhat limited definition of "debtor company" used in CCAA should perhaps include other corporate entities such as, *inter alia*, limited partnerships and other types of partnerships to avoid restricting the use of CCAA to incorporated business entities. At the same time, the rules regarding the treatment of partnerships should be reviewed, to ensure that these entities are treated under the CCAA and BIA as separate persons in their own right and not merely an extension of the partners.

Receiverships

3.42 Codification of receiverships

IC has requested input as to whether it is appropriate to amend the insolvency legislation to clarify the role and authority of a receiver appointed under section 243 of the BIA; and whether it is appropriate to standardize a set of rules regarding the authority of a receiver to act across all insolvencies statutes.

[58] The JTF notes that the potential inclusion of all trusts as entities subject to BIA and CCAA will necessarily trigger reflection as to the contents of « bankruptcy remoteness » opinions traditionally given with respect to trusts subject to Canadian legislation.

JTF Comments

The JTF notes that the receiver provisions as codified in section 243 and following of the BIA under the 2009 Amendments seem to be working efficiently and do not warrant substantive change. Many jurisdictions have implemented model "receivership orders" to standardize the powers and duties of the receiver appointed under section 243 BIA.

This being said, the JTF believes that some other receiver related issues should be eventually addressed, namely the following:

- where a receiver proceeds to a sale of an insolvent person's assets, it should be specified that the proceeds of sale shall be paid to creditors in accordance with the BIA priority scheme. It is unclear under existing provisions whether such priority scheme applies or whether the provincial priority scheme applies;
- it should be specified that the receiver, like the trustee in bankruptcy, is not bound to obtain tax clearance certificates which must otherwise be obtained from tax authorities[59] before distribution where assets are disposed of or otherwise liquidated. Present uncertainty in this regard causes legitimate concerns for receivers who may incur liability for having failed to obtain such tax clearance certificates before proceeding to distribution.

3.43 No Action Against Receivers Without Leave of the Court

IC has requested input as to whether it would be appropriate to amend the insolvency legislation to require leave of the court before taking any action against the Receiver.

JTF Comments

The JTF supports an amendment to section 215 BIA to provide that leave of the court be obtained prior to taking any action against a receiver appointed under section 243 BIA. Like the trustee in bankruptcy and the interim receiver, the receiver appointed under section 243 BIA is a court officer who should benefit from similar protection from frivolous or abusive judicial claims.

3.44 Marshaling of Charges

IC has requested input as to whether it would be appropriate to amend the insolvency legislation to codify the doctrine of marshaling charges.

JTF Comments

The codification of the common law doctrine of "marshalling" in respect to the various charges created under BIA and CCAA is an issue worthy of consideration. Legislative clarification in this regard would be helpful to guide the courts and to allow for the equitable distribution of proceeds subject to charges created under BIA and CCAA.

[59] See for instance section 159 of the *Income Tax Act* and section 14 of the *Quebec Tax Administration Act*, and section 270 of the *Excise Tax Act*.

The JTF notes that this doctrine could also be of use in relation to the enforcement of various Crown Claims (namely deemed trust claims) which purport to charge all of the assets of the insolvent person.

3.45 Tax Issues

IC has requested input on several tax-related issues that have been raised by stakeholders in the insolvency context, to solicit information regarding the nature of concerns and the extent to which such issues potentially affect insolvency proceedings.

JTF Comments

The JTF believes that further study of the interaction of tax laws and insolvency laws is worthy of consideration, as the JTF considers that tax issues presently exist that impede restructuring opportunities for insolvent businesses or delay or cause inefficiencies in the administration of insolvent estates. The more significant areas where some legislative reform is considered to be desirable, in dealing with the interaction between fiscal and insolvency laws are outlined below:

- Clearance Certificates: The JTF believes that the exemption from obtaining clearance certificates available to trustees should be extended to any court officer distributing funds under supervision of a court where notice is given to creditors, as there is no known public policy reason to treat a court officer differently from another court officer acting in a similar capacity under a different statute;

- Final Tax Returns: The JTF perceives a problem relating to the final tax return required to be filed after the final distribution. The JTF believes that trustees, receivers, monitors, or debtors should be dispensed from a requirement to file final tax returns subsequent to effecting a final distribution, when the final distribution occurs in a context of a legal process monitored by the court, with notice to the creditors;

- Unfiled Tax Returns: The JTF believes there is a need for clarification in the legislation regarding the responsibility for filing tax returns with respect to periods more than one year before the commencement of the year in which a person becomes bankrupt, to better coordinate the provisions of Section 22 BIA with the provisions of the *Income Tax Act* ("**ITA**")[60] and the *Excise Tax Act* ("**ETA**")[61] or other similar provincial or federal legislation that provides for an obligation on the part of legal representatives to complete tax returns;[62]

- Jurisdiction over tax claims: The JTF believes that there presently exists some confusion regarding the jurisdiction of each of the court (acting as a designated tribunal under the CCAA or acting in matters of bankruptcy and insolvency) and the tax court in dealing with the acceptance or rejection of claims against an estate, the right to issue assessments and the characterization of such assessments as an administrative gesture or a "proceeding" that may be stayed

[60] RSC 1985, 1 (5th Supp.), as amended.

[61] RSC 1985, c. E-15, as amended.

[62] Section 265 and 266 ETA, sections 128 ITA.

under the provisions of the BIA or CCAA, the manner in which claims based on an assessment are dealt with for voting purposes, appeal periods and the mechanics of asserting the claim (proofs of claims/assessments). The JTF believes it would be worthwhile to investigate the possibility of having a single forum to deal with all claims made against an insolvent debtor or an insolvent estate, and as a consequence the JTF believes some research should be done on the possibility of attributing all responsibility for dealing with tax claims to the court seized with the supervision of the insolvent estate administration or restructuring process, rather than having a shared responsibility between the court and the tax court, as there is no known public policy reason to reserve the right to determine claims of tax authorities to the tax court in insolvency proceedings, give the text of section 4.1 BIA and section 40 CCAA.;

- Delay in asserting tax claims: The JTF believes it may be useful to provide for a legislative mechanism to compel the Crown in right of Canada or a province to file a proof of claim within a specified period, in order to expedite the administration of an estate and the distribution of funds. The JTF recognizes that such a mechanism exists through Section 149 BIA, but notes that an equivalent provision does not exist in the CCAA, although harmonization might be advisable;

- Discharge of court officer: The JTF believes there is an inconsistency in the provisions of the BIA and of the fiscal laws, as relates to obligations of professionals and how these are discharged, and considers that this inconsistency could be clarified through a legislative change. More specifically, the provisions of the BIA provide that when a trustee has fully administered an estate to the court's satisfaction, the trustee may obtain a discharge,[63] however the fiscal laws that provide for a joint and several obligation to report or remit do not provide for any "sunset" provision that terminates this joint and several obligation when the trustee is discharged.[64] The JTF points out the issue is not limited to an order discharging a trustee, but would equally apply to an order of discharge in respect of a receiver appointed by a court or a monitor appointed pursuant to the CCAA;

- Fresh start / tax consequences arising out of an insolvency or restructuring proceeding: The JTF believes that tax consequences arising from the realization of property in an insolvent estate, or arising as a result of a restructuring process, is an issue that needs clarification as the current treatment can impede the ability of a debtor to restructure, or in the alternative may result in an unclear treatment of potential tax liabilities. Under the current regime, if taxable capital gains or recapture or some other taxable gain arises as a result of the realization process in a bankrupt estate, such income is attributed to the estate, whether or not the trustee collected the proceeds of realization of the assets (as the proceeds may have been collected by a secured creditor that has a charge that encumbers the property), and in such a circumstance the law is unclear as to the characterization of the income tax liability that arises from the realization

[63] Section 41(8) BIA.

[64] See for example section 265 ETA and sections 128 and 159 ITA.

process.[65] In the same manner, the gain on settlement of debt that arises after the implementation of a CCAA plan or a BIA proposal, or the capital gains or recaptured depreciation that arise due to a liquidation of assets in a context of a restructuring process, may result in an income tax liability without recourse to any recovery (in the case of a liquidating BIA proposal or liquidating CCAA plan) or a residual debt that endangers the ability of the debtor to continue in business (in the case of a compromise or settlement proposal or plan). The JTF believes that the issue of the tax treatment of transactions that arise in the context of a bankruptcy or restructuring and/or the reassessment of tax attributes needs to be further studied to avoid an unfair result to creditors or an impediment to a restructuring process.

- Deemed period end: The JTF notes that in BIA proposals and CCAA restructurings, because there is no deemed period end on filing, income and sales taxes that were with respect to the pre-filing period could be considered post-filing liabilities that must be paid in full. This is inconsistent with the bankruptcy regime and the *pari passu* principle, and accordingly the JTF believes that consideration should be given to a legislative change that would ensure that the provisions of section 121 BIA and 19 CCAA are applied consistently by all creditors, including the Crown;

- Claims made under Section 296(1)(b) ETA and Section 25 of the Quebec Tax Administration Act (“**QTAA**”)[66]: The JTF notes that the Canada Revenue Agency (“**CRA**”) and the Quebec Revenue Agency (“**QRA**”) have implemented a policy of assessing debtors directly for the goods and services tax (“**GST**”), harmonized sales tax (“**HST**”) and/or Quebec sales tax (“**QST**”) that is payable on purchases made from suppliers who are unpaid at the date of the inception of an insolvency proceeding, without relieving the supplier from the obligation to collect and remit the tax on the taxable supply. The JTF observes that this practice results in duplicative claim for the tax on purchases as such amounts are also claimed by unpaid suppliers of the debtor who are agents of the Crown for the purpose of collecting GST/HST/QST. The duplicative claim implies that the Crown is collecting proceeds of distributions made in an estate twice, on what is essentially the same claim, which results in a higher recovery for the Crown than the other similarly situated ordinary unsecured creditors. The JTF believes that a legislated solution may be required to ensure observance of the *pari passu* principle, while addressing some legitimate concerns of CRA and QRA;

- Set-off claims: The JTF identified the issue of set off of claims in general as being worthy of consideration and in particular the issue of set off as it relates to the Crown. More specifically, the JTF is questioning whether it should be appropriate for taxing authorities to set-off pre-filing tax liabilities as against post-

[65] In a situation where a secured creditor takes possession and realizes on encumbered property, resulting in recaptured depreciation for the estate, the income tax arising from the recaptured depreciation would not be a cost of administration of the estate, nor a claim provable in bankruptcy. However, section 128 of the ITA provides that the trustee is jointly liable with the bankrupt for the payment of such income taxes to the extent of the property of the bankrupt in the trustee’s possession. It is unclear what priority this liability for taxes would have as compared with the fees and costs of the trustee, and why the taxes arising from the realization of property that is not available for distribution to creditors would reduce the amount otherwise available for distribution.

[66] RSQ, c. A-6.002.

filing refunds given the involuntary nature of taxation obligations, the fact that the Crown can invoke a right of set off but the taxpayer is not allowed to do so, and the fact that the set off of Crown claims may extend beyond debts that are truly mutual between the Crown and the debtor;[67]

- Garnishment rights: The JTF believes there is an uncertainty that arises in a situation where the government has issued garnishment notices pursuant to section 317 ETA in the context of a restructuring process, in view of a recent judgment of the Supreme court of Canada.[68] In this decision, the Supreme court found that a garnishment notice issued pursuant to s. 317 ETA is not stayed by the filing of a notice of intention to make a proposal (or a proposal) under the BIA, because the related account receivable is no longer part of the estate of the debtor due to the transfer of property effect of s. 317 ETA, when the garnishment notice has been served onto the account debtor before the filing of the notice of intention. This decision appears to create an inconsistency in the treatment of garnishment notices issued by CRA under various fiscal laws in a context of a restructuring process, since the BIA and ITA suggest that a garnishment notice sent in respect of unpaid source deductions would be suspended by the stay of proceedings, while in virtue of the decision of the Supreme court of Canada, the equivalent notice sent pursuant to the ETA is not. This inconsistent treatment is a cause of concern, given that the legislator has sought, at least since the revisions made to the *Bankruptcy Act* (as it was then known) in 1992, to provide the highest degree of protection to the unremitted source deductions but to allow an opportunity for an insolvent debtor's restructuring to occur. The JTF believes it would be appropriate to clarify the rights of the Crown in a context of a restructuring proceeding, for all of the Crown's debts.

- Claims for payroll source deductions in a proposal or plan of arrangement: The JTF notes that in a context of a proposal under the BIA or a plan of arrangement under the CCAA, there exists a pre-condition to obtaining the approval of the court, that the claims of the Crown that could form the basis of a demand under section 224(1.2) ITA (or a provision of the *Canada Pension Plan* or the *Employment Insurance Act* that refers to section 224(1.2) ITA, or a substantially similar provision of a provincial law) be paid in full within 6 months of the date of ratification, unless the Crown agrees to a longer timeframe. The JTF notes that the claim of the Crown that could form the basis of a demand under section 224(1.2) ITA includes interest and penalties and the employer's portion of some payroll levies, and the JTF is not aware of any public policy reason why the claims of the Crown for interest, penalties and levies might warrant a priority treatment as compared to the claims of ordinary unsecured creditors. Furthermore, the JTF notes that there is uncertainty regarding the requirement of this provision, considering that the demand under section 224(1.2) ITA can only affect accounts receivable of an insolvent person. The uncertainty arises, for example, in a situation where the insolvent person is a retailer who does not customarily have any accounts receivable, or where the collectible value of accounts receivable is lower than the amount due in respect of unremitted payroll source deductions, interest, penalties and levies, as it is then unclear whether the amount that must be remitted within the 6 months (or longer) period must be the

[67] For example, see section 31.1 and 31.1.1 of the QTAA.

[68] *Toronto Dominion Bank v. R*, 2012 CarswellNat 8 (SCC) and 2010 CarswellNat 2936 (F.C.A.).

entire amount due or be limited to the collectible value of accounts receivable. The JTF believes that additional consideration should be given to the treatment of claims of the Crown in a restructuring process, to further clarify the extent of the priority that should attach to a claim of the Crown for unremitted payroll source deductions.

Technical issues

3.46 Disallowance of claims

Submissions are invited as to whether it is appropriate to provide the court with the statutory authority to extend the period for appealing the disallowance of a claim.

JTF Comments

The JTF does not believe that amendments to BIA to grant necessary court authority to extend the 30 day delay within which an appeal may be launched[69] are warranted. Such potential "open ended" appeal period would create uncertainty in many regards as trustees and stakeholders could no longer assume that the disallowance of a claim is final where no appeal nor leave for extension has been filed within 30 days from the disallowance of the claims.

3.47 Securities firm Bankruptcies

Submissions are invited as to whether securities regulators or customer compensation bodies should be able to apply for a bankruptcy order.

JTF Comments

The JTF concludes that this issue appears to be satisfactorily addressed under section 256 BIA and is unaware of recent cases which would justify further amendments in this regard.

3.48 Preview of proposals by the trustee

Submissions are invited as to whether proposal trustees should be provided with a mechanism to prevent the size and complexity of a BIA proposal before they accept it.

JTF Comments

The JTF believes that this issue is worthy of consideration, principally because of the fact that the BIA provides that the proposal trustee is deemed to be trustee in bankruptcy where the proposal process is unsuccessful. The BIA should thus be mindful of the fact that proposal trustees should be able to take informed decisions when they decide to accept an engagement. Further reflection should also be had with regard to a proposal trustee's right to resign from acting in such capacity in certain circumstances.

[69] See sections 135(4) BIA.

4. COMMENTS OF THE JTF WITH RESPECT TO OTHER COMMERCIAL ISSUES THAT ARE NOT RAISED IN THE DISCUSSION PAPER, BUT THAT THE JTF BELIEVES SHOULD BE ADDRESSED IN LEGISLATIVE REFORM

Although these topics are not addressed specifically in the Discussion Paper, the JTF has identified certain issues which, in its view, are worthy of consideration in the context of a review of the BIA and the CCAA, or in the context of a review of the statutes that regularly interact with the insolvency statutes, such as the WEPPA. These issues are outlined briefly hereunder.

4.1 Critical suppliers

Under the 2009 Amendments, provisions regarding payments to critical suppliers of a debtor company were only codified in the CCAA[70]. The JTF believes that the inclusion of similar provisions in the BIA is worthy of consideration as there appears to be no underlying rationale to justify that the critical supplier mechanisms, as codified in the CCAA, be restricted to debtor companies seeking to restructure under the CCAA. It may also be of interest to further reflect upon the allowance of pre-filing payments to critical suppliers while nonetheless maintaining the broad judicial discretion set out in section 11.4 of the CCAA.

4.2 Environmental claims

The treatment of environmental claims made against a debtor company or its directors in the context of a CCAA restructuring has been the object of significant controversy in recent case law, namely in the matters of *Abitibi*[71]*, Northstar*[72] and *Nortel*[73].

The JTF is of the view that various issues related to the definition and treatment of environmental claims made against a debtor company and its directors are worthy of consideration. Such issues include the following:

- a definition of what constitutes an “environmental claim” subject to compromise which may not involve reference or evidence regarding environmental authorities’ intention to proceed to decontamination;

- a clearer distinction between environmental authorities status as regulator or creditor in a restructuring process;

- jurisdiction of the CCAA court in respect to all environmental claims against the company and its directors;

- adequate stay of proceedings protection for the directors of a debtor company where the CCAA process is used to proceed to the sale of assets and where it becomes evident that no plan of arrangement will be filed[74]

[70] See section 11.4 CCAA.

[71] See *Newfoundland and Labrador* v. *AbitibiBowater Inc.,* 2012 SCC 67.

[72] See *Re Northstar Aerospace*, 2012 ONSC 4546.

[73] See *Re Nortel Networks*, 2010 ONSC 1708.

4.3 Set off of pre-filing claims against post-filing claims

In a restructuring context, a creditor's capacity to operate set-off of post-filing claims with pre-filing claims may lead to inequitable treatment of creditors in certain circumstances. Certain courts[75] have broadly interpreted set-off rights to allow for the set-off of post-filing claims with pre-filing claims in a restructuring context.

The JTF believes that it may be worthy of consideration to implement amendments which would restrict set-off rights otherwise available under BIA and CCAA to preclude a creditor from operating set-off between post-filing claims owing to the debtor company and pre-filing claims owing to such creditor by the debtor company except with leave of the court, where the preclusion would lead to an inherently inequitable result..

4.4 Application and implementation issues with respect to sections 38 and 95-101 of the BIA in the context of restructurings under CCAA and BIA

The JTF is of the view that, in a restructuring context, a debtor company's right to include or exclude recourses otherwise available under sections 38 and 95 to 101 of the BIA raises implementation issues which may be worthy of consideration. Without limitation, the debtor's right to exclude, in a proposal[76] or plan of arrangement, sections 38 and 95 to 101 of the BIA is perhaps overreaching, namely insofar as sections 95 to 101 of the BIA include, *inter alia*, section 97(3) of the BIA which sets out applicable set-off principles. It may thus be worthy to determine whether or not it is appropriate that a proposal or plan of arrangement expressly exclude principles of set-off otherwise applicable under section 97(3) of the BIA.

4.5 The extent of director protection under the BIA and the CCAA

The JTF is of the view that the requirement to demonstrate that it is impossible to obtain indemnification insurance for directors and officers at a reasonable cost, before a charge can be ordered to protect directors and officers,[77] should be reconsidered. In a situation where the debtor company is insolvent and a proceeding is looming, it is quite obvious that insurance will not be available or will only be available at a prohibitive cost, unless the insurance contract is pre-existing. As such, the requirement to demonstrate that insurance at a reasonable cost cannot be obtained is quite often an exercise in futility. The JTF believes that the provision could be modified to ensure that any existing insurance protection cannot be terminated or curtailed by reason of the insolvency of the debtor or by reason that an alternative protection is available through the court ordered charge, and to ensure that it serves to complement the indemnity that may otherwise be payable under any existing insurance contract.

The provisions that allow for a court ordered charge to protect directors and officers against liability refer to a liability that is incurred after the filing of the notice of intention or proposal under the BIA or after the commencement of proceedings under the CCAA. The JTF is of the view that the provision could perhaps be clarified to differentiate when the obligation is triggered from when the liability is incurred.

[74] Under section 11.03 of the CCAA, the stay of proceedings undertaken or to be undertaken against the directors is, in theory, only valid « until a compromise or an arrangement in respect of the company is filed ».

[75] See *Re Industries Davie Inc.,* 2000 CarswellQue 7 (C.A.)*, Re Industries Portes Mackie Inc.,* 2000 CarswellQue 431 (C.A.) and *Re Air Canada,* (2003 CarswellOnt 4016 (Ont. S.C.)).

[76] See 36.1 of the BIA.

[77] See section 11.51(3) CCAA and section 64.1(3) BIA.

SCHEDULE A

Legislative review task force (commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals

Methodology

Set-out below is a description of the methodology followed by the Joint Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada ("**IIC**") and the Canadian Association of Insolvency and Restructuring Professionals ("**CAIRP**") (the "**JTF**").in the preparation of the report addressed to Industry Canada ("**IC**") and to its sponsoring organizations, IIC and CAIRP.

Composition of the JTF

Membership of the JTF was established as follows:

Philippe H. Bélanger - **McCarthy Tétrault LLP** - (IIC Co-chair)
Jean-Daniel Breton - **Ernst & Young Inc.**
Sean F. Collins - **McCarthy Tétrault, LLP**
Stephen Ferguson - **Alvarez & Marsal Canada ULC**
Craig J. Hill - **Borden Ladner Gervais, LLP**
Jonathan Krieger - **Grant Thornton Limited** - (CAIRP Corporate Practice Committee Chair)
Todd M. Martin - **Alvarez & Marsal Canada ULC**
Sylvain Rigaud - **Norton Rose Fulbright**
Martin P. Rosenthal - **Ernst & Young Inc.**
John R. Sandrelli - **Dentons Canada LLP**
Robin B. Schwill - **Davies Ward Phillips & Vineberg, LLP**
Steve Weisz - **Blakes, Cassels & Graydon, LLP**
Mitch Vininsky - **Duff & Phelps Canada Restructuring Inc.**
Mark Wentzell - **Grant Thornton Limited**

Methodology

For the purpose of preparing the report, the JTF held weekly or bi-weekly conference calls between February and July 2014 to identify, discuss and analyze the various topics and issues thought to be worthy of consideration in the context of the next legislative round of reform to the *Bankruptcy and Insolvency Act* ("**BIA**") and the *Companies Creditors' Arrangement Act* ("**CCAA**"). From May onwards, the JTF's weekly conference calls dealt primarily with the review and analysis of the topics and issues identified in the Discussion Paper.

In light of the fact that certain issues raised in the Discussion Paper were seen to be more complex and deserving of more detailed analysis, it was decided to form sub-committees to handle such issues. The following sub-committees were thus formed:

Issues relating to intellectual property rights:	Steven Weisz (Chair) John Sandrelli Josef Kruger Michael Creber Sharon Hamilton Nigel Meakin Ashley Taylor Shayne Kukulowicz Jean Fontaine
Issues relating to employee rights:	Craig Hill (Chair) Jean-Daniel Breton Mark Wentzell Bridget Van Wyk
Issues relating to credit bidding and stalking horse bids	Sylvain Rigaud (Chair) Jean-Daniel Breton Sean Collins Neil Narfasson Martin Rosenthal Mark Wasserman
Issues relating to Cross-border insolvencies	Robin B. Schwill (Chair) Mark Wentzell Kibben Jackson Natasha MacParland Prof. Stephanie Ben-Ishai
Tax issues	Aubrey Kauffman (Chair) Peter Farkas Paul Bishop Grant Moffat Robin Schwill Jean-Daniel Breton
Issues relating to eligible financial contracts	Rupert Chartrand Jean-Daniel Breton Patrick Riesterer

No formal consultation of the members of CAIRP and IIC

Because of the short timeframe within which comments were to be provided to IC with respect to the Discussion Paper, the JTF did not have the opportunity to formally poll or otherwise consult respective members of CAIRP and IIC as to the various issues and topics discussed in the report. The report of the JTF may thus not be seen as reflective of the collective views of the membership of each of IIC and CAIRP. It is envisaged that the report shall serve as a template for further reflection, research and discussion with the members of CAIRP and IIC with a view to eventually formulating formal recommendations as to suggested legislative changes to the Canadian insolvency statutes.

SCHEDULE B

Detailed report prepared by the IIC's Derivatives Task Force previously submitted by the IIC to Industry Canada

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Insolvency Institute of Canada
L'Institut d'insolvabilité du Canada

REPORT OF

THE TASK FORCE ON DERIVATIVES

The Insolvency Institute of Canada ("**IIC**") Task Force on Derivatives (the "**Task Force**") respectfully submits this report on behalf of the leading organization of insolvency professionals in Canada. A brief description of the IIC is attached to this Report as Schedule "A". The Report is based on the volunteer efforts of many members of the IIC.

The Task Force was convened to examine the treatment of derivatives and other eligible financial contracts (together, "**EFCs**") under Canadian insolvency law in response to the heightened international scrutiny directed at some derivatives as a result of the 2008 global financial and liquidity crisis. The Task Force has undertaken a comprehensive review of Canadian insolvency statutes. The Report is primarily focused on the EFC provisions of the *Bankruptcy and Insolvency Act*[1] ("**BIA**") and the *Companies' Creditors Arrangement Act*[2] ("**CCAA**"), the two main Canadian insolvency statutes that apply to the insolvencies of commercial enterprises. The Report also considers the EFC provisions under the *Winding-up and Restructuring Act*[3] ("**WURA**").

OVERVIEW

Canadian commercial insolvency law is part of the national framework legislation which is designed to minimize the impact of an insolvency event upon the Canadian economy and to promote a successful restructuring of business enterprises undergoing financial difficulties. A successful restructuring (whether under the same corporate structure, a new legal entity or through a sale of business operations as a going concern) optimizes value for stakeholders, saves jobs, supports communities that rely on local industries, protects the public from losing vital services and encourages the survival of more competitive industries. In the case of financial institutions, the restructuring is also effected to protect special stakeholders such as depositors or policyholders and minimize potential "runs on the bank" which would create instability in financial markets, impair overall liquidity in the financial world and increase systemic risk.

Insolvency law promotes a going concern restructuring of a viable business entity's affairs. When a business entity is brought under insolvency protection, the BIA and CCAA provide a broad stay of rights and remedies against the insolvent entity to encourage a going-concern restructuring of the business where possible. This broad stay is a fundamental tool of Canadian

[1] R.S.C. 1985, c. B-3, as amended.

[2] R.S.C. 1985, c. C-36, as amended.

[3] R.S.C. 1985, c. W-11, as amended.

restructuring insolvency laws. The stay in part prevents a forced liquidation of a struggling business by staying (a) secured and unsecured creditors from realizing on the assets of the insolvent entity and (b) solvent counterparties from terminating contracts with the insolvent entity. Similarly, the *Canada Deposit Insurance Corporation Act*[4] ("**CDIC Act**") provides a broad stay of proceedings and a process to allow the Canada Deposit Insurance Corporation ("**CDIC**") to attempt to restructure a deposit-taking financial institution.

The legislative reforms regarding EFCs under Canadian insolvency law have been piecemeal. EFC protection was introduced into the BIA beginning in 1992, followed by more extensive amendments to the Canadian insolvency laws which generally came into force in 1997 and 2009. Amendments were also made to the CDIC Act and the *Payment Clearing and Settlement Act*[5] ("**PCSA**") to deal with EFCs entered into by certain financial institutions.

The insolvency regime for EFCs consists of a series of exemptions from the law that ordinarily applies to contracts upon the commencement of insolvency proceedings. The EFC "safe harbours" primarily provide an exemption from the stay of proceedings to permit the termination of EFCs by the solvent counterparty, the determination of the net amount owing under the terminated EFCs, the realization upon financial collateral posted in respect of EFCs and protect the priority thereof.

At the outset, the exemptions under insolvency law for the termination and netting of EFCs were in part promulgated on the basis of concerns for certainty in financial markets and competitiveness vis-à-vis the United States and other global markets. After the safe harbour provisions were added to the United States *Bankruptcy Code*,[6] similar protections were added in Canada to ensure that the Canadian market kept pace with global markets. In addition, it was felt that an exemption from stays against termination of EFCs would provide solvent parties with certainty in their dealings, with the anticipated result of encouraging the availability of risk-hedging derivatives for all Canadian enterprises, including those in financial distress.[7]

EFC protection is a significant exception to the stay of proceedings under the CCAA and BIA. There are two main purposes of the EFC safe harbours: (i) to protect non-defaulting counterparties from the risk of increasing exposure to the insolvent counterparty under the EFC and (ii) to reduce systemic risk in Canadian and global financial markets. Non-defaulting counterparties may be at risk because, in certain instances, the amounts under the EFCs are very substantial and the value of the underlying products subject to EFCs are volatile in nature and can change dramatically during an insolvency proceeding. If the solvent counterparty to an EFC is subject to a stay of proceedings and therefore unable to terminate its EFCs with the insolvent counterparty, there is a risk that the value of such EFCs could deteriorate sufficiently (from the

[4] R.S.C. 1985, c. C-3, as amended.

[5] S.C 1996, c. 6, Sch., as amended.

[6] *U.S. Code*, title 11.

[7] Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations respecting Order of Reference from the House of Commons dated Tuesday June 18, 1991 – pre-study of Bill C-22, *An Act to enact the Wage Claim Payment Act, to amend the Bankruptcy Act and to amend other Acts in consequence thereof*, House of Commons, 3rd Sess, 34th Parl, Issue No. 5, September 3, 1991, Chairman Felix Holtmann, at 1017–1018. [CBA Submissions].

insolvent counterparty's perspective) to put the solvent counterparty at risk. Systemic risk may arise where the solvent counterparty is a systemically important institution or where the solvent counterparty has entered into EFCs with one or more other counterparties. In extreme cases, the failure of one counterparty could have a domino effect, where the failure of one counterparty, particularly a derivatives dealer, triggers the failure of a second counterparty who is also a derivatives dealer and the failure of the second counterparty could trigger the failure of others. Multiple insolvencies may cause a lack of liquidity in the financial sector and unavailability of credit to solvent enterprises and, ultimately, systemic risk. The systemic risk could spread to global markets and lead to world-wide financial instability and, in extreme cases, recession.

The 2008 global financial and liquidity crisis precipitated recognition by governments and regulators of the need for a better understanding and more comprehensive regulation of derivatives. At the Pittsburgh Summit in 2009, the G20, including Canada, committed to strengthening the regulation, supervision and infrastructure of the global financial system (the "**G20 Commitments**"). The G20 Commitments include a commitment to attempt to mitigate systemic risk, particularly in the area of over-the-counter ("**OTC**") derivatives, by increasing the transparency of the OTC derivatives market and ensuring more consistent treatment of derivatives in different jurisdictions. To limit systemic risk, the G20 committed in part to the development of an internationally coordinated and comprehensive regulatory framework to facilitate the central clearing of most OTC derivatives according to internationally accepted standards, including insolvency rules.

Recent Canadian federal legislative amendments have focused on meeting the G20 Commitments. Amendments to the PCSA and the CDIC Act were enacted in 2012 primarily to facilitate the clearing and settlement of OTC derivatives by central counterparties and to further facilitate the restructuring of insolvent financial institutions by CDIC.[8] At the provincial level, the Canadian Securities Administrators are introducing rules to regulate more closely the OTC derivatives market and to provide for the central clearing of OTC derivatives.

Combating systemic risk is an important goal. However, the goal of reducing systemic risk has to be balanced against important Canadian insolvency principles which encourage restructuring. The Task Force has considered the treatment of derivatives in Canadian insolvency law in this light. The Task Force is of the view that the current treatment of EFCs in the Canadian insolvency regime does not always strike the right balance between protecting against systemic risk and allowing insolvent commercial enterprises to restructure. The current regime may in some cases impede the restructuring of insolvent enterprises by placing too much emphasis on attempting to reduce systemic risk.

In other cases, the protections against systemic risk may be improved and the Task Force supports strengthening some of the EFC safe harbours. In particular, additional protections should be provided to ensure that EFC counterparties have better priority to financial collateral. This protection against systemic risk can be granted without impeding a restructuring.

[8] On June 27, 2012, the Task Force submitted to the Department of Finance its *Preliminary Review of Federal Legislative Changes to Accommodate Central Clearing of Over the Counter Derivatives*, which expressed its views on a preliminary outline of these amendments that was provided by the Department of Finance to the Task Force and other stakeholders for comment.

As currently drafted, the EFC safe harbours may in some cases deprive the insolvent estate of value to which the estate and its creditors should be entitled. Further, the EFC safe harbours may delay or prevent certain liabilities of the insolvent entity from being crystallized. The Task Force has made certain recommendations aimed at maximizing the value of the estate and enhancing the prospects of a restructuring of an insolvent enterprise without unduly increasing the potential for systemic risk.

In making its recommendations, the Task Force is cognizant of the fact that the global and Canadian regulators have reached a broad consensus that the EFCs entered into by most commercial enterprises pose little or no risk to major financial institutions and therefore do not give rise to systemic risk on a global scale. Global and Canadian regulators have accordingly determined that EFC transactions with commercial enterprise "end-users" of EFCs should be exempt from the mandatory central clearing regime that is being developed primarily for financial institutions.[9] The Task Force recognizes that there is still a potential for systemic risk arising as a result of the failure of a commercial enterprise. However, the Task Force is of the view that the emphasis solely on the potential for systemic risk, however remote, may in some instances be disproportionate given the impact that the EFC safe harbours may have on the ability of a commercial enterprise to restructure and on the recoveries of other creditors of the insolvent counterparty.

As noted above, EFCs receive special protection because (i) liabilities under EFCs are often based upon large notional amounts and (ii) the values of the underlying reference items and the financial collateral securing EFC obligations are highly volatile and significant fluctuation of these values can occur during an insolvency proceeding.

In addition, the EFC exemptions were introduced to make Canadian institutions competitive in the global derivatives market and to ensure Canadian enterprises have access to the global derivatives markets.

For these reasons, the Task Force does not recommend a repeal of the fundamental EFC safe harbour provisions under the BIA, the CCAA and, to the extent they are available in respect of a trading company, the WURA, but rather recommends a series of modifications to alleviate the EFC safe harbour provisions with a view to achieving a better balance between the objectives of insolvency legislation and financial risk.

The Task Force is making recommendations regarding the following broad categories:

A. Allow the termination of EFCs by the insolvent entity or its court appointed officer.

B. Allow the assignment of EFCs by the insolvent entity or its court appointed officer.

C. Prohibit walk-away clauses in EFC contracts.

D. Increase the priority of EFC financial collateral.

[9] See Basel Committee on Banking Supervision & Board of the International Organization of Securities Commissions, *Margin requirements for non-centrally cleared derivatives* (Bank for International Settlements: September 2012) at p. 9; see also Canadian Securities Administrators, *CSA Consultation Paper 91-405, Derivatives End-User Exemption* (Canadian Securities Administrators Derivatives Committee: April 13, 2012).

E. Protect the central clearing of OTC derivatives.

F. Protect EFCs in receiverships.

The Report is presented from an insolvency point of view. The recommendations are primarily meant to promote restructurings and to preserve value for an insolvent commercial enterprise and its stakeholders. The recommendations should, however, be considered in light of the impact, if any, which they would have on the ability of Canadian financial institutions and solvent enterprises to access the global derivatives markets. Canadian EFC protections under insolvency law should be periodically reviewed in light of ongoing international legal developments.

RECOMMENDATIONS

Termination of EFCs

1. The prohibition on disclaimer or resiliation[10] of EFCs by the insolvent party in section 32(9) of the CCAA and section 65.11(10)(a) of the BIA should be repealed. If the solvent party does not terminate the EFC, the insolvent party should have the power to do so on the following basis:

   (a) the insolvent party should not be able to disclaim EFCs until 30 days after the insolvency filing.

   (b) at the end of the 30 day period, the same regime for disclaimer of agreements found in section 32 of the CCAA and section 65.11 of the BIA should apply to the disclaimer of an EFC, including a 30-day notice period and a 15-day objection period.

   (c) cherry-picking of EFCs during the disclaimer process should be expressly forbidden.

2. A receiver appointed under Part XI of the BIA, a trustee in bankruptcy and a liquidator appointed under the WURA should also have the power to disclaim EFCs 30 days after their appointment by the Court on the following basis:

   (a) a trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

   (b) a receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of other contracts under section 65.11 of the BIA.

[10] To simplify the text, the terms disclaimer and disclaim will be used throughout this text to also mean resiliation and resiliate.

(c) cherry-picking of EFCs should also be expressly forbidden.

Assignment of EFCs

1. The prohibition on assignment of EFCs by the insolvent party in section 11.3(2)(b) of the CCAA and section 84.1(3)(b) of the BIA should be repealed.

2. An insolvent entity, a trustee in bankruptcy, receiver under Part XI of the BIA and a liquidator of an insolvent insurance company under Part III of the WURA should be able to apply to the Court for an order assigning an EFC pursuant to the process provided for the assignment of other contracts in the CCAA and BIA on notice of the court motion seeking the assignment to the non-defaulting counterparty and other affected parties which, except in the case of insurance company insolvencies, is not less than 30 days.

3. The non-defaulting counterparty should not be permitted to terminate an EFC from the date the court makes an order assigning the EFC or such later date as may be set by the court.

4. Cherry-picking of EFCs to be assigned should be expressly forbidden and all contracts associated with an assigned EFC should be required to be assigned as well.

Walk-Away Clauses

The solvent counterparty should not be able to refuse to make net termination payments to the insolvent party on termination of an EFC because of the commencement of insolvency proceedings or any steps taken during the insolvency proceedings, such as a disclaimer of an EFC by the insolvent counterparty. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything on termination, disclaimer or assignment of an EFC that is, in substance, equivalent to a walk-away clause.

Financial Collateral

1. Financial collateral should have priority over the super-priority liens for (i) certain wages pursuant to sections 81.3 and 81.4 of the BIA, (ii) certain pension amounts pursuant to sections 81.5 and 81.6 of the BIA and (iii) the deemed trusts pursuant to section 227 of the *Income Tax Act* ("**ITA**"),[11] section 23 of the *Canada Pension Plan*[12] ("**CPP**"), section 86 of the *Employment Insurance Act*[13] ("**EIA**"), and substantially similar provisions of provincial legislation.[14]

2. Financial collateral should be limited to those listed assets that are posted with, pledged to or specifically assigned to the solvent counterparty or under the control of an entity other than the insolvent counterparty or its related entities or that are subject to set-off or

[11] R.S.C. 1985, c. 1 (5th Supp), as amended.

[12] R.S.C. 1985, c. C-8, as amended.

[13] S.C. 1996, c. 23, as amended.

[14] For example, section 20 of the Quebec *Tax Administration Act* ("**QTAA**"), R.S.Q. c. A-6.002, as amended.

netting rights with the solvent counterparty or where title to the assets has been transferred by the insolvent debtor pursuant to a title transfer credit support agreement.

OTC Derivatives

1. The definitions of "clearing house", "clearing member" and "margin deposit" in Section 95(3) of the BIA should be expanded to cover derivatives clearing houses clearing derivatives transactions.

Receiverships

1. The receivership provisions in the BIA should be amended to ensure that a court does not have the power to stay a solvent counterparty from terminating an EFC in accordance with its terms, calculating net termination values of an EFC and netting or setting-off and dealing with financial collateral in accordance with the terms of an EFC. Such an amendment would make the provisions in certain Model Receivership Orders mandatory rather than discretionary. The amendment would result in standard treatment of EFCs in all receivership proceedings across Canada, as well as harmonizing receiverships with bankruptcies.

2. Section 88 of the BIA should be amended to apply to receiverships under Part XI of the BIA. The BIA should protect financial collateral to ensure that financial collateral posted with or pledged to secure an EFC is not primed by charges granted pursuant to a receivership order, including provisions granting a super-priority charge to a receiver in respect of the receiver's borrowings and the receiver's and other professional's fees.

DISCUSSION OF RECOMMENDATIONS

A. Termination of EFCs by Insolvent Estate

In the context of amendments to the BIA and CCAA codifying the process by which an insolvent debtor may disclaim agreements, provisions came into force in 2009 to prevent the debtor from terminating an EFC. Section 65.11(10) of the BIA was introduced to prohibit an insolvent debtor seeking to restructure under the BIA proposal provisions from disclaiming certain types of contracts, including EFCs. Similarly, section 32(9) of the CCAA was introduced to prohibit a debtor company from disclaiming an EFC. The reason for including EFCs in the list of contract types exempted from the disclaimer power was to permit the solvent counterparty to control the timing of termination so that it is able to effectively rehedge its exposure on derivatives transactions. As currently drafted, there is no time limit imposed on the solvent counterparty's unilateral right to terminate an EFC, which has the potential to create problems during a restructuring.

The EFC exemption from the disclaimer power can create an impediment to a successful restructuring and does little, if anything, to minimize systemic risk. To restructure successfully, a business operation needs to be cleared of burdensome contracts, including EFCs, and be able to crystallize and compromise claims of creditors. Further, if the insolvent party is "in the money" on a net basis on its EFCs with a counterparty, it should also have the opportunity to benefit from the net termination values. The permanent stay on termination of an EFC by the insolvent counterparty and the possibility of a reliance by the solvent counterparty on walk-away clauses in the EFC (as discussed below) impede both these goals.

The inability to disclaim an EFC can create uncertainty for the insolvent party and may prevent it from realizing value, which is counterproductive to the objectives of the insolvency legislation. If no action is taken by the solvent party and the insolvent party is not allowed to take action, then the insolvent party may lose a valuable asset because of changes in the market. The products underlying an EFC are often volatile. Furthermore, the fact that the solvent party may take action at any time with little prior notice creates uncertainty for the insolvent party, as the extent of its debt load cannot be known with certainty until all contracts have been terminated or have expired. This situation can affect the chances of success of a restructuring proceeding.

The solvent counterparty's unilateral right to terminate the EFC need not be indefinite to protect against systemic risk. It is important that the insolvent enterprise be given an opportunity to attempt to restructure and emerge from the insolvency process as a viable business. The Task Force is therefore of the view that the insolvent counterparty should have the right to terminate the EFC after an appropriate period.

The Task Force is of the view that giving the debtor a right to terminate EFCs in accordance with the general contract disclaimer regime under the BIA and CCAA will balance the rights of the solvent counterparty and the potential for systemic risk with the need to facilitate a restructuring. The same process for the disclaimer of contracts by an insolvent debtor should apply to EFCs. This process requires the insolvent party to give 30 days' notice of its intent to disclaim a contract. Upon the commencement of the 30 day notice period, the other party to the contract has a 15 day period to object to the disclaimer of the contract by applying to the court for an order that the contract not be disclaimed. Since the termination of EFCs is not stayed, a 30 day notice period will also allow the solvent counterparty a relatively lengthy period of time during which it may terminate the EFC on a date of its own choosing.

Termination of certain derivatives contracts may require the solvent counterparty to rehedge its position. To facilitate re-hedging, the Task Force is of the view that the insolvent debtor should not be able to give notice of its intent to disclaim EFCs until 30 days after the date of the insolvency filing.

Further, the solvent counterparty would have an additional 30 days to re-hedge under the existing notice regime for the disclaimer of contracts. This would give the solvent counterparty a total of at least 60 days before an EFC can be terminated by an insolvent debtor. In section 32(4) of the CCAA and section 65.11(5) of the BIA, when deciding whether to allow a disclaimer, the court is to consider, among other things, whether the disclaimer would likely cause significant financial hardship to a party to the agreement. The court has the discretion to refuse to allow the disclaimer or to extend the 30 day notice period to protect the solvent counterparty from the disclaimer of any contract if financial hardship is an issue. Financial hardship could arise where a solvent counterparty to an EFC may experience difficulty in rehedging its position during the 60 day time period. In such circumstances, the court could refuse to allow the disclaimer or could extend the time period to minimize the financial hardship.

In addition to businesses attempting to restructure, the right to disclaim EFCs should also be available to a trustee in bankruptcy under the BIA, a receiver appointed under the BIA, and the liquidator appointed under the WURA.[15] An insolvent estate, even if not restructuring, should not, as a matter of policy, lose value merely because of the commencement of insolvency proceedings. This is contrary to the general goal of maximizing value for all stakeholders. Further, there is a need to crystallize claims against the estate where the solvent counterparty has an in-the-money position to allow for a timely distribution to the creditors.

A trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

A receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of ordinary contracts under section 65.11 of the BIA.

The right to disclaim would not apply to any EFC transactions that have been cleared.

Members of the Task Force are of the view that the disclaimer regime should not permit an insolvent entity, trustee in bankruptcy, receiver or liquidator to cherry-pick valuable EFCs. Cherry-picking is unfair to the solvent counterparty and has the potential to provide certain creditors of the estate with an undeserved windfall at the solvent counterparty's expense. The disclaimer of EFCs should be permitted only where all EFCs with the same solvent counterparty are also disclaimed. This will prevent the insolvent entity from terminating only in-the-money contracts with the solvent party and impair the netting of obligations under other EFCs with the same counterparty. The Task Force recommends that the language used in section 39.15(7.2) of the CDIC Act be used as a guide to prevent cherry-picking.[16]

[15] The IIC has previously recommended significant amendments to the WURA, including restricting its application to financial institutions. For a detailed review of the WURA recommendations, see the Insolvency Institute of Canada's *Winding-Up and Restructuring Act: Recommendations for Reform* (June 14, 2002).

[16] Section 39.15(7.2) of the CDIC Act provides as follows:

> The Corporation may assign to a bridge institution eligible financial contracts — including any claim under such contracts — that are between a federal member institution and an entity or any of the following entities provided that the Corporation assigns all of those eligible financial contracts to the bridge institution:
>
> (a) another entity that is controlled — directly or indirectly — by the entity;
>
> (b) another entity that controls — directly or indirectly — the entity; or
>
> (c) another entity that is controlled — directly or indirectly — by the entity referred to in paragraph (b).

Recommendations on Termination of EFCs

1. The prohibition on disclaimer of EFCs by the insolvent party in section 32(9) of the CCAA and section 65.11(10)(a) of the BIA should be repealed. If the solvent party does not terminate the EFC, the insolvent party should have the power to do so on the following basis:

   (a) the insolvent party should not be able to disclaim EFCs until 30 days after the insolvency filing.

   (b) at the end of the 30 day period, the same regime for disclaimer of agreements found in section 32 of the CCAA and section 65.11 of the BIA should apply to disclaimer of an EFC, including the requirement that 30 days' notice be given and the right of a solvent counterparty to object within 15 days of the provision of such notice.

   (c) cherry-picking of EFCs during the disclaimer process should be expressly forbidden.

2. A receiver appointed under Part XI of the BIA, a trustee in bankruptcy and a liquidator under the WURA should also have the power to disclaim EFCs 30 days after their appointment by the Court on the following basis:

   (a) a trustee in bankruptcy should have the authority under section 30 of the BIA, with the permission of the inspectors of the bankrupt estate, to disclaim an EFC in the same manner as an insolvent debtor can disclaim other contracts under section 65.11 of the BIA.

   (b) a receiver under Part XI of the BIA or a liquidator under the WURA should be able to apply to court on notice to the solvent counterparty to disclaim an EFC on providing 30 days' notice to the solvent counterparty. The solvent counterparty should be able to object in court to the disclaimer on the same grounds as for the disclaimer of ordinary contracts under section 65.11 of the BIA.

   (c) cherry-picking of EFCs should also be expressly forbidden.

B. Assignment of EFCs

In the context of amendments to the BIA and CCAA codifying the process by which an insolvent debtor may assign agreements, provisions also came into force in 2009 to prevent an insolvent debtor from assigning an EFC. Section 84.1(3)(b) of the BIA was introduced to prohibit a trustee in bankruptcy (and, by virtue of section 66 of the BIA, an insolvent debtor seeking to restructure under the BIA proposal provisions) from assigning an EFC. Similarly, section 11.3(2)(b) of the CCAA was introduced to prohibit a debtor company from assigning an EFC. The reason for including EFCs in the list of contract types exempted from the forced assignment power was to permit the solvent counterparty to control who is the new counterparty in a derivatives transaction.

The ability to assign EFCs would preserve and maximize value for the insolvent estate and may increase recoveries to creditors. The right to apply to court for an order assigning an EFC would most likely be used in the context of a sale of an entire book of business or a sale of a whole business, including EFCs entered into by the previous owner to hedge certain risks faced in that industry.

The right to assign EFCs is particularly important for Canadian insurance companies. Many Canadian insurance companies are major financial institutions. These companies have significant derivative books of business, particularly in their "dynamic hedging" programs for interest rates, equities and other risks. A major task of a liquidator of an insurance company appointed under Part III of the WURA is to seek to restructure the insolvent company's business portfolio so that it can be acquired by another insurance company. This maximizes value and protects policyholders. This objective is very similar to a restructuring of other financial institutions such as banks.

The court motion seeking an assignment of EFCs should be subject to the normal assignment provisions in the BIA and the CCAA, including evidence of the ability of the assignee to perform under the EFC, the assignee being an appropriate person to be assigned the rights and obligations under the EFC and the assignee curing any outstanding monetary defaults[17] under the EFC within the time fixed by the court.

To allow the solvent counterparty ample time to consider the proposed assignment and determine whether it can accept the proposed assignee, the notice of motion seeking an order assigning the EFC should be made on at least 30 days' notice to the solvent counterparty. During that period, the solvent counterparty will be able to terminate the EFC if it is not satisfied with the information provided to it and the court or if it does not accept the proposed assignee as the new counterparty. This termination right would survive until the court makes an order assigning the EFC or such later date as may be set by the court.

In the case of insurance company insolvencies, the liquidator need not be limited to a 30-day notice period. The treatment of the sale of assets, including derivatives, in proceedings in respect of an insolvent insurance company should be similar to the treatment of such sales in insolvency proceedings in respect of other regulated financial institutions. To protect policyholders and the stability and confidence in financial markets, a liquidator may need to sell the whole book of business early in the liquidation process.

The right to seek court approval of an assignment of an EFC would not apply to any EFC transactions that have been cleared.

For the same reasons as for the termination of EFCs, there should not be any cherry-picking on the assignment of EFCs with the same counterparty and all contracts associated with an assigned EFC should be required to be assigned as well.

[17] Other than monetary defaults triggered by the debtor's insolvency, failure to meet financial covenants, accessing the relief provided by an insolvency statute, or other similar default.

Recommendations on the Assignment of EFCs

1. The prohibition on assignment of EFCs by the insolvent party in section 11.3(2)(b) of the CCAA and section 84.1(3)(b) of the BIA should be repealed.

2. An insolvent entity, a trustee in bankruptcy, receiver under Part XI of the BIA and a liquidator of an insolvent insurance company under Part III of the WURA should be able to apply to the Court for an order assigning an EFC pursuant to the process provided for the assignment of other contracts in the CCAA and BIA on notice of the court motion seeking the assignment to the non-defaulting counterparty and other affected parties which, except in the case of insurance company insolvencies, is not less than 30 days.

3. The non-defaulting counterparty should not be permitted to terminate an EFC from the date the court makes an order assigning the EFC or such later date as may be set by the court.

4. Cherry-picking of EFCs to be assigned should be expressly forbidden and all contracts associated with an assigned EFC should be required to be assigned as well.

C. Prohibition of Walk-Away Clauses

In a typical derivatives contract, when the contract is terminated, the party who is "out of the money" must pay the party who is "in the money." However, clauses are sometimes, though rarely, included in EFCs which override the typical provision by affording one counterparty the right to walk away from a termination payment that would otherwise be due to the other counterparty when the second counterparty commits certain specified defaults, including becoming subject to insolvency proceedings (such provision a "**walk-away clause**").

The EFC safe harbours were not intended to create a benefit for solvent counterparties. The EFC safe harbours were first suggested as a means to facilitate the termination of EFCs on a timely basis where one counterparty has become the subject of insolvency proceedings and were intended to benefit both the solvent and insolvent counterparties. The provision permits the solvent counterparty to terminate an EFC at market price, and gives rise to a net amount that may well be payable to the insolvent counterparty, rather than to the solvent counterparty. The exemption from the stay facilitates the determination of a fixed and certain value to the EFC and the right of both counterparties to collect such amount, just like an amount owed under any other contract at the time of the stay.[18]

Walk-away clauses have the potential to create significant windfalls for the counterparties that have the benefit of such clauses while causing significant harm to defaulting (insolvent) counterparties and their creditors. Walk-away clauses are disproportionately favourable to the non-defaulting counterparty and do not protect against systemic risk. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything that is, in substance, equivalent to a walk-away clause.

[18] CBA Submissions, *supra* note 7.

Certain provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*[19] ("**Dodd-Frank Act**") recently enacted in the United States provide that no walk-away clauses shall be enforceable with respect to certain covered financial companies.[20]

Walk-away clauses should be prohibited under the BIA, CCAA and WURA. The capital adequacy requirements published by the Office of the Superintendent of Financial Institutions require certain financial institutions to disregard EFCs that include walk-away clauses for purposes of measuring the financial institution's regulatory capital and for calculating netting in respect of same.[21] Even if the capital adequacy rules are sufficient to prevent certain financial institutions from inserting walk-away clauses in their EFCs, many derivatives dealers and other persons carrying on business through trading or entering into derivatives may not be subject to the same or similar capital adequacy rules. A standard rule for all EFCs should apply.

Prohibiting walk-away clauses will make the EFC safe harbours more consistent with Canadian insolvency law principles and the initial justification for the EFC safe harbours.

Recommendation on Prohibition of Walk-Away Clauses

1. The solvent counterparty should not be able to refuse to make net termination payments to the insolvent party on termination of an EFC because of the commencement of insolvency proceedings or any steps taken during the insolvency proceedings, such as a disclaimer of an EFC by the insolvent counterparty. The BIA, CCAA and WURA should be amended to render ineffective any provisions in an EFC that have the effect of providing for or permitting anything on termination, disclaimer or assignment of an EFC that is, in substance, equivalent to a walk-away clause.

D. Financial Collateral

The EFC safe harbours in the BIA, CCAA and WURA permit a solvent counterparty to realize upon financial collateral notwithstanding any stay resulting from the commencement of insolvency proceedings.[22] The protection for financial collateral came into force in September 2009.

Canadian insolvency law purports to give a solvent counterparty almost unlimited rights to enforce on its interests in financial collateral. The EFC safe harbours permit "any dealing with financial collateral" including sale, foreclosure and set off. Further, section 88 of the BIA provides that no order may be made under the BIA in relation to a bankruptcy or a proposal if the

[19] Pub. L. 111-203; H.R. 4173.

[20] Dodd-Frank Act, s. 210(c)(8)(F). The U.S. courts have also not supported clauses which are in effect walk-away clauses: *Lehman Bros. Holding Inc. v BNY Corporate Trustee Servs. Ltd.*, 2010 BL 14861 (2010, U.S. Brtcy. Ct., S.D.N.Y.); *In Re Lehman Brothers Special Finance Inc. v Ballyrock ABS CDO 2007-1 Limited et al.*, 452 B.R. 31 (2011, U.S. Brtcy. Ct., S.D.N.Y.).

[21] Office of the Superintendent of Financial Institutions Canada, *Guideline: Capital Adequacy Requirements* (Effective Date: January 2013).

[22] The CDIC Act also provides solvent counterparties with a similar right to realize on financial collateral, subject to the one day stay that may result if CDIC is appointed receiver of the insolvent financial institution.

order would have the effect of subordinating financial collateral. Section 34(11) of the CCAA similarly provides that no order may be made under the CCAA if the order would have the effect of subordinating financial collateral.

Despite these clear pronouncements, the current provisions in Canadian insolvency law do not always clearly delineate who has priority over financial collateral. Section 81.3 of the BIA attributes an absolute priority to certain employee wage claims against current assets, subject only to certain deemed trusts in favour of the Crown[23] ("**Crown**"); and section 81.5 of the BIA attributes an absolute priority to certain pension claims against all the assets of the bankrupt, subject only to the employees' wage claims under section 81.3 of the BIA and certain of the Crown's deemed trusts. The assets potentially encumbered by the super-priority statutory lien for wage and pension claims against the insolvent could include financial collateral. Further, the Crown's deemed trust provisions could have priority over the solvent counterparty's rights to financial collateral.

The Task Force is of the view that the solvent counterparty should have a first ranking right to the financial collateral, ahead of the various statutory priorities for employees, pension plans and unremitted source deduction and withholding taxes, and that the above-mentioned statutory priorities should not affect the solvent counterparties' set-off or netting rights under EFCs. Unlike other security interests, financial collateral is one of the fundamental building blocks to protect against the potential for systemic risk arising in respect of EFCs.

The Task Force is also of the view that the definition of financial collateral as it relates to the type of security taken is too broad given the enhanced priority recommended for solvent counterparties with respect to financial collateral. To ensure that the Task Force's recommendation regarding the increased priority to financial collateral for solvent counterparties does not have a negative impact on employees, pension plans or the Crown, the scope of the security over financial collateral should be limited to collateral that is posted with or pledged to the solvent counterparty or in the control of an entity other than the insolvent counterparty, either as it exists on the date of the initial insolvency event or thereafter. These limits on the scope of the priority for the security over financial collateral will appropriately protect the interests of employees, pension plans and the Crown without the potential for increasing systemic risk.

One potential problem that the Task Force has identified with the current broad definition of financial collateral arises because a charge on financial collateral could resemble a floating charge on cash and securities which come into existence after an insolvency filing. In current banking practice, it is not unusual for a lender to offer an interest rate and/or foreign exchange swap as part of the financial arrangements under a credit agreement. These swaps qualify as EFCs. Generally, a lender will enter into a separate swap agreement with the borrower, but the swap will be secured by the same general security agreement or hypothec on the universality of the borrower's assets that also secures the credit facility. The collateral relied on for the general loan is mainly bank accounts, inventory and accounts receivable, which generate or provide the cash for repayment of the general loan. Allowing the borrower to use the same collateral for the swap as for the general loan improves the borrower's liquidity as the borrower does not need to

[23] The deemed trusts pursuant to section 227 of the ITA, section 23 of the CPP, section 86 of the EIA, and substantially similar provisions of provincial legislation. See *supra* note 14.

separately post cash or securities as collateral for the swap. The amounts owing from time to time under the swap generally do not reduce the credit line by the full amount of the swap.

Problems could arise in an insolvency where there the same general security agreement secures both the general loan and the EFCs granted pursuant to that loan. Upon the insolvency of the borrower, a lender that provides a swap that is secured by a general security agreement or an hypothec on the universality of a borrower's assets may take the position that the cash in the borrower's operating account or certain other current asset collateral under the general security agreement or hypothec is financial collateral. Interpreting the assets subject to the general security agreement as financial collateral could mean that the general lender, in its capacity as swap counterparty, is allowed to realize on the assets of the debtor including assets acquired by the debtor after the insolvency filing notwithstanding the stay that would normally apply to it in its capacity as secured creditor. Further, if the assets are financial collateral, the general lender in its capacity as swap counterparty potentially has priority over any charge to secure interim financing (colloquially, "**DIP**" financing) as well as over all assets acquired by the debtor after the insolvency filing (including any DIP financing drawn after the insolvency filing).

The current broad definition of financial collateral therefore has the potential to undermine many insolvent entities' restructuring efforts. The current definition of financial collateral could be interpreted in a way that would allow a solvent counterparty that has security under a general security agreement to seize the operating bank accounts or other securities of the insolvent counterparty at any time following default and, if the operating account is not seized, the solvent counterparty could require post-filing cash received by the borrower to be swept into an account controlled by the solvent counterparty to which the insolvent counterparty would not have access. The solvent counterparty could also argue that a court cannot grant a charge over the assets securing the swap (relying on CCAA s. 34(11)) and that these assets must be used to satisfy EFC obligations. This could have a serious impact on the restructuring efforts of the insolvent counterparty. The insolvent counterparty will need cash and current assets to operate and will likely need the ability to give security over its current assets in order to obtain interim financing.

The Task Force is particularly concerned about the scope of financial collateral given its recommendation that claims of a solvent counterparty to financial collateral be given priority over the claims of wage earners for unpaid wages, pensioners for unremitted pension contributions and taxing authorities for unremitted source deductions.

However, the limitation on the type of security or arrangement over financial collateral which can be given first ranking security status may lead some lenders to require from the borrower, in addition to a general security agreement or hypothec on the universality of the undertaking, a posting of collateral which could affect the liquidity needs of a solvent or insolvent party. Adoption of this recommendation should take this market risk factor into account.

Recommendations for Financial Collateral

1. Financial collateral should have priority over the super-priority liens for (i) certain wages pursuant to sections 81.3 and 81.4 of the BIA, (ii) certain pension amounts pursuant to sections 81.5 and 81.6 of the BIA and (iii) the deemed trusts in favour of the Crown

pursuant to section 227 of the ITA, section 23 of the CPP, section 86 of the EIA, and substantially similar provisions of provincial legislation.[24]

2. Financial collateral should be limited to those listed assets that are posted with, pledged to or specifically assigned to the solvent counterparty or under the control of an entity other than the insolvent counterparty or its related entities or that are subject to set-off or netting rights with the solvent counterparty or where title to the assets has been transferred by the insolvent debtor pursuant to a title transfer credit support agreement.

E. Central Clearing of OTC Derivatives

The Canadian regulators, in conjunction with other foreign regulators, are establishing international standard rules to require that the more standard OTC derivatives be cleared through derivatives clearing houses. The clearing houses will require their participating members to post collateral and make margin deposits to secure the obligations of the participating members to the clearing house.

Section 95 of the BIA deems bodies which clear securities and its members to be dealing at arm's length and exempts a securities clearing house from the rebuttable presumption that a payment has been made or that security has been taken with an intent to give the clearing house a preference over other creditors of the clearing member.

The Task Force is of the view that derivatives clearing houses should benefit from the same exemption under the BIA preference rule.

Recommendation for OTC Derivatives

1. The definitions of "clearing house", "clearing member" and "margin deposit" in Section 95(3) of the BIA should be expanded to cover derivatives clearing houses clearing derivatives transactions.

F. Receiverships under Part XI of the BIA

The provisions dealing with national receiverships and the appointment of a receiver by the Court pursuant to the BIA were introduced as part of the amendments that came into force in September 2009. Previously, the BIA did not provide for the appointment of a receiver by the Court, although it provided for the appointment of interim receivers in the context of a proposal, an application for a bankruptcy order or an intention by a secured creditor to enforce its security. Prior to 2009, courts in some provinces had given an expansive interpretation to the interim receivership provisions exercising their inherent jurisdiction such that interim receiverships were effectively full receiverships. In 2009, interim receivers were returned to their original role with limited powers and the ability to act only on an interim basis.

The amendments that came into force in 2009 did not deal with EFCs and no safe harbours apply in the receivership context. As such, while the CCAA and BIA contain exemptions for certain remedies in respect of EFCs in bankruptcy and restructuring situations, there is no mention of EFCs in the context of receiverships.

[24] For example, section 20 of the QTAA.

Prior to the amendments to the BIA, receivership was an equitable remedy which relied upon the broad jurisdiction of the courts in common law jurisdictions. The *Civil Code of Quebec*[25] and *Code of Civil Procedure*[26] do not specifically provide for the appointment of a receiver by the Court as an equitable remedy. Over time, receiverships have evolved. Courts outside of Quebec have used their inherent jurisdiction to impose a very broad stay of proceedings in a receivership to stay the termination of contracts, similar to a stay imposed by a court in a CCAA proceeding. This practice has continued to develop since 2009. The Quebec courts are sometimes reticent to grant a stay in such circumstances.

The Task Force has concluded that EFC safe harbours should be expressly provided in a receivership in the same fashion as elsewhere in the BIA and CCAA. Currently, protection of EFCs is solely at the discretion of the court exercising its inherent powers. Some provinces have developed Model Receivership Orders. Several Model Receivership Orders provide that the receivership stay does not apply in respect of an EFC,[27] but this protection is not uniform. For example, the Saskatchewan Model Receivership Order does not exempt EFCs from the receivership stay. In addition, Model Orders are discretionary. A court can choose to grant a broader stay in certain circumstances. The discretionary nature of the stay and the lack of uniformity among the provinces should be addressed to ensure that systemic risk is appropriately curtailed. Further, EFC safe harbours should be added to receiverships to ensure that regulators and market participants have the level of legal certainty they require for these types of rights.

The BIA provides that no order can be made in the context of a bankruptcy or proposal which has the effect of subordinating financial collateral. The BIA is silent on the effect of receiverships on financial collateral. The Model Receivership Orders developed, however, provide for a super-priority charge for the Receiver's and the Receiver's other professional fees over all the property of the debtor and a super-priority charge for the Receiver's borrowings over all the property of the debtor (collectively, the "**Receiver's Charges**"). The Receiver's Charges in the Model Receivership Orders generally have priority over every lien, charge, encumbrance and security interest except the environmental lien (BIA, s. 14.06(7)), the wages charge (BIA, s. 81.4(4)) and the pension charge (BIA, s. 81.6(2)).[28] Accordingly, the Receiver's Charges granted by a court generally prime financial collateral. The Receiver's Charges are therefore generally broader than the charges in the CCAA in favour of the monitor and DIP lenders. The

[25] S.Q. 1991, c. 64, as amended.

[26] R.S.Q. c. C-25, as amended.

[27] See section 9 of the Ontario Model Receivership Order, available on the webpage of the Ontario Court of Superior Justice, Commercial List, http://www.ontariocourts.ca/scj/en/commerciallist/; section 8 of the British Columbia Model Receivership Order, available on the website of the British Columbia Supreme Court, http://www.courts.gov.bc.ca/supreme_court/practice_and_procedure/practice_directions/civil/PD%20-%2016%20Model%20Receivership%20Order.pdf; and section 10 of the Alberta Model Receivership Order, available on the webpage of the Alberta Court of the Queen's Bench, http://www.albertacourts.ab.ca/LinkClick.aspx?fileticket=SI1sMgHbIXw%3d&tabid=324&mid=839.

[28] See sections 17 and 20 of the Ontario Model Receivership Order; sections 16 and 19 of the British Columbia Model Receivership Order; sections 16 and 19 of the Saskatchewan Model Receivership Order; and section 16 and 19 of the Alberta Model Receivership Order. Note that the Alberta Model Receivership Order does not explicitly state that the statutory liens and charges for the environment, unpaid wages and unpaid pension amounts have priority over the Receiver's Charges.

Task Force is of the view that Receiver's Charges should not be permitted to prime financial collateral.

Recommendations for Receiverships

1. The receivership provisions in the BIA should be amended to ensure that a court does not have the power to stay a solvent counterparty from terminating an EFC in accordance with its terms, calculating net termination values of an EFC and netting or setting-off and dealing with financial collateral in accordance with the terms of an EFC. Such an amendment would make the provisions in certain Model Receivership Orders mandatory rather than discretionary. The amendment would result in standard treatment of EFCs in all receivership proceedings across Canada, as well as harmonizing receiverships with bankruptcies.

2. Section 88 of the BIA should be amended to apply to receiverships under Part XI of the BIA. The BIA should protect financial collateral to ensure that financial collateral posted with or pledged to secure an EFC is not primed by charges granted pursuant to a receivership order, including provisions granting a super-priority charge to a receiver in respect of the receiver's borrowings and the receiver's and other professional's fees.

September 26, 2013

SCHEDULE "A"

The Insolvency Institute of Canada/L'institut d'insolvabilité du Canada

The Insolvency Institute of Canada is Canada's premier private sector insolvency organization. The Institute is a non-profit organization dedicated to the recognition and promotion of excellence in the field of insolvency. Its members are drawn from the most senior experienced members of the insolvency community in Canada. Membership is by invitation and is limited to 135 insolvency practitioners (trustees and lawyers) who are joined by representatives of regulatory and compensation bodies, major financial institutions and prominent members of the academic community.

The Institute provides a forum for leading members of the insolvency community to exchange ideas and share experiences with other members, senior representatives of the federal and provincial governments and members of the judiciary. The Institute supports and encourages research studies and analysis of restructuring, insolvency and creditors' rights issues. Since its inception, members of the Institute have always had prominent roles in the review and reform of Canada's insolvency legislation.

The Institute publishes papers on insolvency related topics in the annual Journal of the Insolvency Institute of Canada. Members regularly prepare and deliver presentations on technical, academic and professional matters at the Institute's Annual General Meetings. The Institute has commissioned research projects on important issues in Canada's insolvency and restructuring system. The Institute has established links with Canada's leading bankruptcy and insolvency judges. The Institute, in association with one of Canada's leading publishers, makes its collection of insolvency cases and materials available electronically.

The Institute, through its members, brings a wealth of judgment and experience to its activities and projects and is becoming increasingly recognized as the most authoritative multidisciplinary insolvency organization in Canada.

TAB 113

Discovery Practice in British Columbia

Second Edition

Lyle G. Harris, Q.C.

THE CONTINUING LEGAL EDUCATION
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3. Obtaining Documents from an Ongoing Police Investigation [§2.114]
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Parties to an action are entitled to know what relevant documents are or have been in the possession of other parties, and to inspect and get copies of documents that are not privileged: Rule 7-1 under the Supreme Court Civil Rules (the "SCCR") (B.C. Reg. 168/2009). Documents in the possession of non-parties may also be produced. The ability to obtain proper document discovery can be the single most important factor in the outcome of a case. The recollections of witnesses (even honest ones) can be faulty or coincident with their own interests in the matter. Contemporaneous documentary records are rarely fabricated and frequently provide the most reliable evidence on a particular point.

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I. EXAMINATION FOR DISCOVERY DEFINED [§3.1]

An examination for discovery is an oral examination under oath of a party to an action, conducted by another party "adverse in interest" (Rule 7-2 of the Supreme Court Civil Rules (the "SCCR")). A critical step in any litigation, the examination can help counsel understand the nature of the other side's case, gain admissions for use at trial, commit an opposing witness to his or her testimony, and narrow the issues in the litigation. Conducted effectively, the examination for discovery lays the groundwork for successfully resolving a case out of court, or presenting the best case at trial.

II. ENTITLEMENT TO EXAMINE FOR DISCOVERY [§3.2]

A party is entitled to examine for discovery those parties who are "adverse in interest" (SCCR Rule 7-2(1)). Adversity of interest is determined by the pleadings (*British Columbia v. Terry Logging Ltd.* (1984), 57 B.C.L.R. 265 (C.A.)).

Entitlement to examine continues even after a party discontinues his or her claims, provided that adversity of interest continues to be present on the pleadings. In *Lee v. Merrill Lynch Canada Inc.*, 2003 BCSC 80 (Warren J.), an elderly patient brought an action under the *Patients Property Act* against several defendants, alleging breach of fiduciary duty and various causes in the handling of her estate. Two of the defendants, children of the plaintiff, joined two other siblings as defendants by counterclaim. Subsequently the plaintiff discontinued her action, with the issue of costs left undetermined. The court held that the plaintiff could be examined for discovery where she was clearly adverse in interest, even though her claim had been discontinued.

A. PLAINTIFFS V. DEFENDANTS; DEFENDANTS V. DEFENDANTS [§3.3]

Plaintiffs and defendants are obviously adverse in interest and may discover each other. In claims involving more than one defendant, each defendant who raises issues against other defendants in the statement of defence may examine those other defendants for discovery. The pleadings must always be examined to determine whether adversity of interest is raised.

B. PLAINTIFFS v. THIRD PARTIES [§3.4]

There are two types of third parties:

(1) a party against whom a third party notice is delivered under SCCR Rule 3-5; and

(2) the Insurance Corporation of British Columbia ("ICBC"), when it voluntarily delivers a third party notice under s. 77 of the *Insurance (Vehicle) Act*. In motor vehicle actions that do not

TAB 114

THE LAW OF EVIDENCE IN CANADA

FOURTH EDITION

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admissible in the subsequent civil action, the latter proceeding must have arisen out of the same or similar circumstances which formed the basis of the criminal charge.[607]

§6.419 Similarly, a statement by a party while under oath or contained in an affidavit may be used as an admission in the course of subsequent civil litigation.[608]

(b) Apologies

§6.420 Apologies contain or imply an acknowledgment of responsibility and, therefore, counsel often advise clients not to apologize while litigation is pending for fear that the apology would constitute an admission of liability. Yet, apologies, in and of themselves, may be beneficial in repairing relationships or ameliorating the circumstances simply through the acknowledgment of the hurt or loss that has been suffered. A sincere apology may even reduce or eliminate a plaintiff's need to sue. British Columbia, in 2006, was the first province to pass legislation, the *Apology Act*[609] which allows the benefits of apologies without the attendant risk that such a statement will be considered an admission of liability. The Act is designed to promote the early and beneficial resolution of civil disputes by allowing parties to express sincere regret or remorse by removing concerns that an apology constitutes an admission. The Act protects apologies made in connection with any matter, other than in a criminal context, and deems them inadmissible as evidence regarding the fault or liability of a person in any British Columbia court, arbitration or other tribunal proceeding. The Act expressly states that an apology does not constitute an admission of fault or liability or confirmation of a course of action, and must not be taken into account in the determination of fault or liability in connection with the matter to which it relates. "Apology" is defined to mean an expression of sympathy or regret, a statement that one is sorry or any other words or actions indicating contrition or commiseration, whether or not the words or actions admit or imply an admission of fault in connection with the matter to which the words or actions relate.

§6.421 Other provinces have followed this initiative removing the adverse legal implications of an apology.[610]

[1960] B.C.J. No. 80 (B.C.S.C.); *Ferris v. Monahan* (1956), 4 D.L.R. (2d) 539, [1956] N.B.J. No. 11 (N.B.C.A.).

[607] *Hellyer Farms Ltd. v. Biro*, [1971] 2 O.R. 583, [1971] O.J. No. 1555 (Ont. Co. Ct.).

[608] *Tipping v. Hornby* (1960), 32 W.W.R. 287, [1960] B.C.J. No. 6 (B.C.S.C.).

[609] S.B.C. 2006, c. 19.

[610] Alberta: *Evidence Act*, R.S.A. 2000, c. A-18, s. 26.1; Manitoba: *Apology Act*, S.M. 2007, c. 25; Newfoundland and Labrador: *Apology Act*, S.N.L. 2009, c. A-10.1; Nova Scotia: *Apology Act*, S.N.S. 2008, c. 34; Ontario: *Apology Act, 2009*, S.O. 2009, c. 3; Saskatchewan: *Evidence Act*,

(b) Statements by a Representative or by Persons with Identity of Interest

§6.462 Statements made by a trustee, executor or administrator of an estate in that capacity will constitute an admission against the beneficiaries.[669] Accordingly, if statements are made by a party in a representative capacity and were made in that connection, those statements are admissible against the party he or she represents.[670] The rationale is that there is a sufficient identity of interest to allow for attribution of the statement to the party.

§6.463 Identity of interest also serves to permit the reception of an admission in various disparate situations: for example, a statement by one partner to a business enterprise made in the course of the business affairs of the partnership is admissible as evidence against all partners;[671] an admission of a deceased tortfeasor is evidence against his executor or administrator;[672] and, the admission of an officer of a bankrupt company is evidence against the trustee in bankruptcy in an action by a lien claimant.[673]

§6.464 Similarly, admissions made by predecessors in title, or other persons in privity with a party, are admissible in evidence against the party. In *Woolway v. Rowe*,[674] it was held that a statement made by the plaintiff's father, the previous owner of the plaintiff's lands, to the effect that he did not possess the right asserted by the plaintiff in the present action, was admissible as against the plaintiff.

§6.465 It is difficult to delineate all the relationships which would qualify as constituting a sufficient privity or identity of interest as to permit the admissibility of vicarious submissions. Suffice it to say that it would include any relation which permits one person's rights, obligations or remedies to be

compromise because "it takes into account the interest of both the State and the individual". However, this compromise fails to recognize the substantial penalties which may be imposed for summary conviction proceedings and is inconsistent with the identification doctrine of corporate criminal liability; see *R. v. Canadian Dredge & Dock Co.* (1985), 19 C.C.C. (3d) 1, [1985] S.C.J. No. 28 (S.C.C.).

[669] *New's Trustee v. Hunting*, [1897] 1 Q.B. 607, at 611, affd [1897] 2 Q.B. 19 (C.A.).

[670] In *D.C. Gem Craft Inc. v. Pafco Insurance Co.* (1998), 40 O.R. (3d) 218, [1998] O.J. No. 2547 (Ont. C.A.), the investigative report of a claims adjuster to an insurer was held to be admissible in an action against the insurer.

[671] *B.C. Iron Works Co. v. Buse* (1894), 4 B.C.R. 419 (B.C.C.A.).

[672] *Adams v. Public Trustee; Chiasson v. Public Trustee* (1971), 23 D.L.R. (3d) 557, [1971] B.C.J. No. 679 (B.C.C.A.).

[673] *Dieleman Planer Co. v. Elizabeth Townhouses Ltd.* (1972), 27 D.L.R. (3d) 692, [1972] B.C.J. No. 729 (B.C. Co. Ct.), affd (1973) 38 D.L.R. (3d) 595, [1973] B.C.J. No. 847 (B.C.C.A.), affd [1975] 2 S.C.R. 449, [1974] S.C.J. No. 105 (S.C.C.).

[674] (1834), 1 Ad. & El. 114, 110 E.R. 1151.

affected by the acts of another person and, therefore, includes what has become known as privity of obligation and privity of title.[675]

(c) *Statements by Persons Engaged with Others in a Common Purpose or Design (Co-Conspirators)*

(i) Exception to the Hearsay Rule

§6.466 Conspirators also have an identity of interest, albeit criminal or tortious. Statements made by a person engaged in an unlawful conspiracy are receivable as admissions as against all those acting in concert if the declarations were made while the conspiracy was ongoing and were made towards the accomplishment of the common object.[676] The admissions of a co-conspirator by words or conduct may be used as proof against the others on the basis that there is an implied authority given to all members of the conspiracy to act or speak in furtherance of the common purpose on behalf of the others. For the exception to apply, there must be evidence of conspiracy, or a common design, and there must be evidence, other than the hearsay statements themselves, that the accused is probably a party to the common design. If so established, hearsay statements by other parties in furtherance of the common design are admissible for their truth against the accused to determine if the accused is an actual member of the conspiracy.[677] As distilled in *R. v. Wang*,[678] this then is a three-stage test as set out in *R. v. Carter*:[679]

(1) The trier of fact must consider all of the evidence to determine whether the existence of a conspiracy has been proved beyond a reasonable doubt.
(2) The trier of fact considers only the evidence directly admissible against the accused to determine if the accused is probably a member of the conspiracy.
(3) Once the first two stages are established, the trier of fact may consider all of the evidence, including the out-of-court acts and declarations of other members of the conspiracy and made in furtherance of the conspiracy to determine if the accused is an actual member of the conspiracy. This determination is beyond a reasonable doubt.

§6.467 The co-conspirator's exception to the hearsay rule applies to both civil[680] and criminal conspiracies. In addition, the rule applies not only to charges for

[675] 4 Wigmore, *Evidence* (Chadbourne rev. 1972), § 1076, at 153.

[676] *R. v. Moore* (1984), 15 C.C.C. (3d) 541, at 570, [1984] O.J. No. 134 (Ont. C.A.), leave to appeal refused (1985), 7 O.A.C. 320*n* (S.C.C.).

[677] *R. v. Carter*, [1982] 1 S.C.R. 938, 67 C.C.C. (2d) 568, [1982] S.C.J. No. 47 (S.C.C.).

[678] (2013), 299 C.C.C. (3d) 431, [2013] B.C.J. No. 1407, at para. 48 (B.C.C.A.).

[679] [1982] 1 S.C.R. 938, 67 C.C.C. (2d) 568, [1982] S.C.J. No. 47 (S.C.C.).

[680] *Consolidated Coal Co. v. Big Chief Woodyard Ltd.*, [1934] 3 D.L.R. 668, [1934] B.C.J. No. 72 (B.C.S.C.); *Great West Uranium Mines Ltd. v. Rock Hill Uranium Ltd.*, [1955] 4 D.L.R. 307, [1955] S.J. No. 53 (Sask. C.A.); *Insurance Corp. of British Columbia v. Atwal* (2012), 4 C.C.L.I.

of the contemporaneous statements to the informant and because although the accomplice might have been available to testify, he was unlikely to be a cooperative witness. The Court also upheld the finding by the trial judge that the statements by the co-conspirator met the reliability requirement under the principled approach.[708]

(vi) Statements by Co-Conspirators that Do Not Constitute Hearsay

§6.485 Statements that are not introduced as proof of the truth of their contents do not constitute hearsay and are not required to undergo the same scrutiny as hearsay statements. With respect to conspiracy cases the following has been stated:

> As noted in *R. v. Smith*, 2007 NSCA 19, 216 C.C.C. (3d) 490, the distinction between hearsay and non-hearsay is 'both critical and difficult to draw in conspiracy cases. ... In many instances, acts and declarations of co-conspirators may not be hearsay but original circumstantial evidence of the existence of the conspiracy, but these same acts and declarations may be hearsay for the purposes of proving who were members of the conspiracy.'[709]

§6.486 In addition, testimony by a co-conspirator with respect to actions and statements by another co-conspirator does not engage the co-conspirator exception to the hearsay. Such evidence is directly admissible against the specific co-conspirator.[710]

5. *Effect of a Party's Admission as Against Others*

§6.487 Admissions are binding only as against the party who made them.[711] Accordingly, an admission by one party is not evidence against a co-defendant, and in a jury trial, the jury is to be cautioned against using the admission in that manner.[712] Thus, in a matrimonial proceeding where a spouse is accused of adultery and B is named as the co-respondent, if the spouse made an out-of-court admission of adultery with B, such admission is admissible as against the spouse only and does not constitute any evidence against B. The reason for this is that, as against B, the extra-judicial statement of the spouse is hearsay. While a party who has made an out-of-court admission cannot rationally complain of

[708] *R. v. Y. (N.)* (2012), 113 O.R. (3d) 347, [2012] O.J. No. 5165, at paras. 85 and 88 (Ont. C.A.).

[709] *R. v. Lees* (2009), 271 B.C.A.C. 186, [2009] B.C.J. No. 1078, at para. 16 (B.C.C.A.). See also *R. v. Wang* (2013), 299 C.C.C. (3d) 431, [2013] B.C.J. No. 1407, at paras. 61-63 (B.C.C.A.).

[710] *R. v. Connolly* (2001), 226 Nfld. & P.E.I.R. 87, 176 C.C.C. (3d) 292, [2001] N.J. No. 374 (Nfld. C.A.); *R. v. Yumnu* (2010), 269 O.A.C. 48, 260 C.C.C. (3d) 421, [2010] O.J. No. 4163 (Ont. C.A.), affd 2012 SCC 73, [2012] S.C.J. No. 73 (S.C.C.).

[711] *Chote v. Rowan*, [1943] O.W.N. 646, [1943] O.J. No. 262 (Ont. C.A.).

[712] *Harris v. Harris*, [1931] 4 D.L.R. 933, [1931] O.J. No. 261 (Ont. S.C.).

I. FORMAL ADMISSIONS

A. In Civil Cases

§19.1 A formal admission in civil proceedings is a concession made by a party to the proceedings that a certain fact or issue is not in dispute. Formal admissions[1] made for the purpose of dispensing with proof at trial are conclusive as to the matters admitted. As to these matters, other evidence is precluded as being irrelevant[2] but, if such evidence is adduced, the court is bound to act on the admission even if the evidence contradicts it.[3] A formal admission should be distinguished from an informal admission. The latter is admitted into evidence as an exception to the hearsay rule and does not bind the party making it, if it is overcome by other evidence.[4]

§19.2 A formal admission may be made: (1) by a statement in the pleadings or by failure to deliver pleadings;[5] (2) by an agreed statement of facts filed at the trial;[6] (3) by an oral statement made by counsel at trial,[7] or even counsel's silence in the face of statements made to the trial judge by the opposing counsel with the intention that the statements be relied on by the judge;[8] (4) by a letter written by a party's solicitor prior to trial;[9] or (5) by a reply or failure to reply to a request to admit facts.[10] A formal admission of fact, as distinct from an

[1] On occasion, they have also been termed "express" or "judicial" admissions. In *Doe d. Spence v. Welling* (1866), 11 N.B.R. 470 (N.B.C.A.), the terms "solemn admissions" and "admissions *in judicio*" were employed.

[2] *Dominion Art Co. v. Murphy* (1923), 54 O.L.R. 332, at 340, [1923] O.J. No. 47 (Ont. C.A.); *Levesque v. Albert* (1976), 16 N.B.R. (2d) 205, at 208, [1976] N.B.J. No. 251 (N.B.C.A.); *Rocca Construction Ltd. v. Gen. Labourers' & Gen. Worker's Union, Local 1079* (1979), 27 N.B.R. (2d) 457, [1979] N.B.J. No. 242 (N.B.C.A.).

[3] *Copp v. Clancy* (1957), 16 D.L.R. (2d) 415, at 425, [1957] N.B.J. No. 28 (N.B.C.A.); *Urquhart v. Butterfield* (1887), 37 Ch. D. 357, at 369 and 374 (C.A.).

[4] See Chapter 6, Hearsay, 6.418.

[5] See, by way of example, the Ontario *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, rr. 19.02(1)(a) and 25.07(2).

[6] *Patterson v. Scherloski* (1971), 21 D.L.R. (3d) 641, [1971] O.J. No. 1706 (Ont. H.C.J.).

[7] *Copp v. Clancy* (1957), 16 D.L.R. (2d) 415, [1957] N.B.J. No. 28 (N.B.C.A.).

[8] *Meunier v. Canadian Northern Railway Co.* (1911), 3 Alta. L.R. 345, 17 W.L.R. 539 (Alta. C.A.).

[9] *Ellis v. Allen*, [1914] 1 Ch. 904, [1911-13] All E.R. 906 (Ch. Div.); *Wright v. Pepin*, [1954] 2 All E.R. 52, [1954] 1 W.L.R. 635 (Ch. Div.); *Plainsman Dev. Ltd. v. Builders Contract Mgmt. Ltd.* (1982), 20 Sask. R. 298, at 300, [1982] S.J. No. 1140 (Sask. Q.B.).

[10] Requests to admit facts are provided for in the provinces: Ontario, *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, r. 51.02(1); Alberta, *Rules of Court*, Alta. Reg. 124/2010, r. 6.37; British Columbia, *Supreme Court Civil Rules*, B.C. Reg. 168/2009, r. 7-7; Manitoba, *Queen's Bench Rules*, Man. Reg. 553/88, r. 51.02(1); New Brunswick, *Rules of Court*, N.B. Reg. 82-73, r. 51.01; Newfoundland and Labrador, *Rules of the Supreme Court, 1986*, S.N.L. 1986, c. 42, Sched. D, r. 33.01; Northwest Territories, *Rules of the Supreme Court of the Northwest Territories*, N.W.T. Reg. R-010-96, r. 294(1); Nova Scotia, *Civil Procedure Rules*, Royal Gaz., Nov 19, 2008, Part 1, r. 20.03; Prince Edward Island, *Rules of Civil Procedure*, r. 51.02(1); Saskatchewan, *Queen's Bench Rules of Court 2013*, r. 6-51.

TAB 115

ESSENTIALS OF
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CONFLICT OF LAWS

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Conflict of Laws

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D. CHARACTERIZATION

Characterization is central to the choice of law process. It is the means by which we identify which choice of law rule to use to determine the applicable law. Often very little thought is given to characterization—the parties know their dispute is about breach of contract, so they turn automatically to the choice of law rule for contract. But in other cases it is less clear what legal category or issue is involved, making it unclear which choice of law rule should be used.

Take the example of a construction crew on its way to a day of work. It spots a warehouse in danger of imminent collapse, and so instead spends the day shoring up temporary supports for the warehouse so as to prevent a collapse. The crew then contacts the warehouse owner and demands payment for its services. If the owner refuses to pay, and the crew sues, we have a variety of ways to explain the crew's claim. It could be in contract: the law might imply a promise by the owner to pay for the work. It could be in tort: the owner might have negligently created a dangerous situation which required immediate attention. It could be in unjust enrichment: the owner has been enriched by the value of the services, the enrichment is at the expense of the crew, and there is no juristic reason for the enrichment. It could be a *sui generis* claim, in its own special category: some legal systems recognize a claim based on *negotiorum gestio*, rooted in Roman law and dealing with the uninvited intervention by one party in the affairs of another.[17]

In a purely-domestic case not much may turn on how we characterize the crew's claim.[18] But if the crew and the owner were both from Detroit, and the warehouse itself was in Windsor, characterization becomes very important. To determine whether Michigan or Ontario law applies, we have to characterize the claim and then use the relevant rule, whether for contract, tort, unjust enrichment, or something else.

This is a good place to make a suggestion about pleadings. In much Canadian civil litigation the parties are not required to plead domestic law.[19] It is sufficient to plead the material facts on which the claim is based and then to indicate what is being claimed, such as damages, as a result of those facts. However, in the example above, if the crew does not plead any law, it is open for the owner to ask the court, for purposes of

[17] For a description see Peter Birks, *Unjust Enrichment*, 2d ed. (Oxford: Oxford University Press, 2005) at 22–23.

[18] In some jurisdictions the relevant statute of limitations has different periods for different causes of action.

[19] As discussed in Chapter 12, they are required to plead foreign law.

plicable to an issue of intestate succession to movable property was Spanish law, looked to what Spanish law considered to be within that legal category. While the first stage of characterization used the law of the forum, the second stage used the *lex causae*. This approach to the second stage can create considerable problems. Suppose an issue is characterized by Manitoba law as part of the law of tort and by Spanish law as part of the law of contract. A Manitoba court will apply the choice of law rule for tort. If the applicable law is Spanish and the *lex causae*, Spanish law, is used for the second stage of characterization, the focus will be on ascertaining what Spanish law considers to be its tort law. This will not properly address the issue, because, as noted at the outset, Spanish law characterizes that issue as contractual.

To avoid the problem in cases like *Re Maldonado's Estate*, and in keeping with the overall analysis of the approach to characterization, the law of the forum should be used for both the first and second stages of characterization. This approach will at times be sensitive to differences between legal systems, as in its treatment of the types of property, but it is firmly grounded in the forum legal system's own internal divisions of law.

E. AMBIGUITIES IN APPLYING THE CHOICE OF LAW RULE

1) *Renvoi*

The choice of law rule indicates which system of law will be applied to resolve a dispute. So if the rule for tort is to apply the law of the place of the tort, and the tort clearly happened in France, the court applies French law. By "French law" we mean here the internal or domestic tort law of France. We do not, as a rule, mean all of French law, including in particular its choice of law rules.

However, in some circumstances the court could instead consider the choice of law rules of the applicable legal system. If French law were applicable, the court would then examine the French rule for choice of law in tort. If it also pointed to French law, its internal law would be applied. But if it pointed to another legal system, the rules of that system would be applied. This approach uses the doctrine of *renvoi*.

Renvoi means "reference back," but there are two related types of *renvoi*: remission, where the reference is back to the law of the forum, and transmission, where the reference is to another system of law. Under remission, the Ontario rule points to France and the French issues of procedure and not of substance.[28] Even if the dispute will be resolved using a foreign law, that law cannot, by virtue of being the applicable law, give to the plaintiff a status he, she, or it otherwise lacks under the law of the forum. For example, for an individual to sue in Ontario independently in his or her own name, he or she must be eighteen years old.[29] It does not matter if he or she is sixteen and is resident or domiciled in a country where that is a sufficient age to so sue. The forum's requirement governs.

However, this rule would cause significant problems if strictly applied to non-natural persons. For example, for a corporation to sue in Ontario, must it meet Ontario's requirements for a valid corporation, in terms of share structure, number of directors, and so on? In practice this would mean a large number of foreign corporations would lack status to sue in Ontario. Each jurisdiction can allow non-natural persons like corporations, partnerships, and trusts to be created in slightly different ways. Strict insistence on the law of the forum for status questions would be a major barrier to cross-border litigation.

Accordingly, the status of non-natural persons is governed by the law of the person's "home" jurisdiction, such as the place of incorporation for a corporation. If the person has the status to sue or be sued under that law, that will be accepted by the forum. In *International Association of Science and Technology for Development v. Hamza* the plaintiffs, which were Swiss societies, were recognized as legal entities under Swiss law but had no such status under Alberta law. They sued in Alberta and the defendants challenged their status to sue. The Court of Appeal noted the general rule that foreign corporations, validly created under the law of a foreign country, could sue as corporations in a common law province of Canada.[30] It extended that rule to unincorporated foreign entities, holding that "the law tends to support a granting of status in cases where the entity in question is recognized as a legal or juridical person by the laws of its home jurisdiction, in the sense of having status to sue."[31] In the court's view this approach was consistent with the comity principle.

[28] *Regas Ltd. v. Plotkins*, [1961] S.C.R. 566 at 571–72; *International Association of Science and Technology for Development v. Hamza* (1995), 28 Alta. L.R. (3d) 125 at para. 9 (C.A.) [*IASTD*].

[29] In Ontario, see Ontario Rules, above note 27, r. 1.03(1), which defines "disability" to include being a minor, r. 7.01(1), which requires those under a disability to use a litigation guardian, and the *Age of Majority and Accountability Act*, R.S.O. 1990, c. A.7, s. 1, which sets the age of majority at eighteen.

[30] *IASTD*, above note 28 at para. 27.

[31] *Ibid.* at para. 37. See also, on the issue of limited partnerships, *Devon Canada Corp. v. PE-Pittsfield, LLC (c.o.b. as Pittsfield Generating Co., LP)*, [2008] A.J. No. 1263 (C.A.).

TAB 116

CHOICE OF LAW FOR EQUITABLE DOCTRINES

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Characterization, as the first step in the forum's choice of law process, must logically begin with the law of the forum, but it does not mean the *domestic* law of the forum. In *Macmillan*, Auld LJ stated that characterization was a matter for the law of the forum.[4] Staughton[5] and Aldous[6] LJJ also proceeded on that basis. However, as Auld LJ added: **3.06**

> . . . classification . . . the underlying principle of which is to strive for comity between competing legal systems, should not be constrained by particular notions or distinctions of the domestic law of the *lex fori*, or that of the competing system of law, which may have no counterpart in the other's system. Nor should the issue be defined too narrowly, so that it attracts a particular domestic rule under the *lex fori* which may not be applicable under the other system . . .[7]

Choice of law categories are different from domestic categories, not least because they must accommodate differences in foreign law. For example, the movable/immovable classification is used instead of the domestic personalty/realty classification.[8] Thus, 'contract' in common law choice of law includes agreements that domestic English law would not enforce as contracts,[9] and 'tort' for the statutory choice of law rules[10] may include civil wrongs unknown to the forum. **3.07**

The characterization exercise should be carried out with consideration given to the functions served by the relevant laws and institutions and not merely by the way they are formulated under domestic law.[11] In *Adams v National Bank of Greece SA*,[12] whether a foreign bank succeeding to another legal entity was liable for obligations excluded by the succession legislation was characterized not as a question of universal succession, as it appeared in the foreign domestic law, but as contractual, as it appeared to English conflict of laws. **3.08**

Choice of law categories are functional categories in the sense that they are intended to bring together problems which, because of their similarity, ought to share the same connecting factor. It is not possible to define what 'similarity' means. Characterization is the process of 'refining English conflict rules by expressing them with greater precision'.[13] Staughton LJ[14] approved of the methodology propounded in *Dicey and Morris*, that the **3.09**

[4] [1996] 1 WLR 387 (CA) 407.

[5] ibid 392 (by implication, in endorsing the approach in *Dicey and Morris*, which rejects the notion of choice of law within characterization).

[6] ibid 417 (common ground of counsel).

[7] ibid 407. Approved in *Raiffeisen Zentralbank Österreich AG v Five Star Trading LLC* [2001] EWCA Civ 68, [2001] QB 825 at para 28.

[8] *Re Berchtold* [1923] 1 Ch 192.

[9] *Re Bonacina* [1912] 2 Ch 394 (CA).

[10] Private International Law (Miscellaneous Provisions) Act 1995, s 9(2).

[11] WW Cook, *Logical and Legal Bases of Conflict of Laws* (1942) 158–170.

[12] [1961] AC 255.

[13] *Dicey and Morris* para 2-034.

[14] [1996] 1 WLR 387 (CA) 392.

court should 'consider the rationale of the English conflict rule and the purpose of the rule of substantive law to be characterized. On this basis, it can decide whether the conflict rule should be regarded as covering the rule of substantive law'.[15] This is consistent with the statement in *Raiffeisen Zentralbank Österreich AG v Five Star Trading LLC* that choice of law categories have no inherent value beyond their purpose in assisting the court to find the most appropriate law to determine the dispute before it,[16] emphasizing the purposive approach in characterization.

3.10 The approach is consistent with the objective of finding a rule that is fair to apply to the parties, and that is also fit to apply by virtue of precedent to those parties in future litigation. It strives towards the objective of uniformity in requiring an international attitude in the characterization process. This goal is not achievable so long as different choice of law methodologies are used in different countries, but it is a goal worth pursuing if there are many other countries applying the same methodology. The approach meets the criticism that the characterization approach is mechanistic and fails to take adequate account of the social purposes of the law, while the retention of categories provides the ballast for certainty within the choice of law process. In overtly addressing the issue of the functions of the categories, it addresses a common criticism that the courts covertly manipulate characterization.[17]

3.11 Finally, reference should be made to the effect of international instruments on characterization. Where such instruments are concerned, the problem is technically one of statutory interpretation rather than characterization as such.[18] For example, under the Rome Convention, 'contract' has an autonomous European meaning,[19] and may be broader in some respects and possibly narrower in others than the English notion of contract. However, characterization is still important in respect of the approach to these instruments. The purpose of the relevant statutory provision is, like characterization, to deal with differences in domestic legal systems,[20] and

[15] *Dicey and Morris* (12th edn, 1993) 44; see now *Dicey and Morris* para 2-035.

[16] [2001] EWCA Civ 68, [2001] QB 825 at para 27.

[17] eg, RC Cramton *et al*, *Conflict of Laws* (5th edn, 1993) 39ff (characterization as an 'escape device').

[18] A Briggs (2003) 119 LQR 352.

[19] Art 18. Efforts are in progress to convert the Convention into a Community instrument so that the ECJ can rule on questions of its interpretation when such questions are referred to it by national courts: 'Green paper on the conversion of the Rome Convention of 1980 on the law applicable to contractual obligations into a Community instrument and its modernization', available at: http://europa.eu.int/eur-lex/en/com/gpr/2002/com2002_0654en01.pdf (last accessed: 6 January 2004).

[20] M Giuliano and P Lagarde, 'Report on the Convention on the Law Applicable to Contractual Obligations' [1980] OJ C282 (31 October 1980) (cited below as '*Giuliano-Lagarde Report*') 38.

TAB 117

SUPREME COURT
OF BRITISH COLUMBIA
VANCOUVER REGISTRY

AUG 16 2016

ENTERED

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*,
S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT
OF WALTER ENERGY CANADA HOLDINGS, INC., AND THE OTHER PETITIONERS
LISTED ON SCHEDULE "A"

PETITIONERS

ORDER MADE AFTER APPLICATION
(APPROVAL AND VESTING ORDER)

BEFORE THE HONOURABLE) TUESDAY, THE 16TH DAY OF
)
MADAM JUSTICE FITZPATRICK) AUGUST, 2016

ON THE APPLICATION of the Petitioners coming on for hearing at Vancouver, British Columbia, on the 15th and 16th day of August, 2016; AND ON HEARING Mary I.A. Buttery, H. Lance Williams, Marc Wasserman and Patrick Riesterer, counsel for the Petitioners and the Partnerships listed on **Schedule "A"** hereto (collectively, the "**Walter Canada Group**"), Peter Reardon and Wael Rostom, counsel for KPMG Inc. in its capacity as the court-appointed monitor of the Walter Canada Group (the "**Monitor**") and those other counsel listed on **Schedule "B"** hereto; AND UPON READING the material filed, including the Third Affidavit of William E. Aziz sworn August 9, 2016 (the "**3rd Affidavit**"), the Confidential Fourth Affidavit of William E. Aziz sworn August 9, 2016 (the "**Confidential Affidavit**"), the Fourth Report of the Monitor dated August 11, 2016 (the "**4th Report**") and the Confidential Supplemental Report of the Monitor dated August 11, 2016 (the "**Confidential Report**" and, collectively with the Confidential Affidavit, the "**Confidential SISP Materials**"); AND UPON BEING ADVISED that the secured creditors who are likely to be affected by this Order were given notice;

THIS COURT ORDERS AND DECLARES THAT:

DEFINITIONS

1. Capitalized terms used and not defined herein shall have the meaning ascribed thereto in the Initial Order in these proceedings dated December 7, 2015 (the "**Initial Order**") or the Sale Agreement (defined below), as applicable.

APPROVAL OF THE SALE AGREEMENT

2. The sale transaction (the "**Transaction**") contemplated by the Asset Purchase Agreement dated August 8, 2016 (the "**Sale Agreement**") between Walter Energy Canada Holdings, Inc., and the other entities listed in Schedule A thereto (collectively, the "**Seller**"), Conuma Coal Resources Limited (the "**Purchaser**") and the Guarantors party thereto (collectively, the "**Parties**"), a copy of which is attached as Exhibit "A" to the Confidential Affidavit, is hereby approved, and the Sale Agreement is commercially reasonable. The execution of the Sale Agreement by the Seller is hereby authorized and approved, and the Seller is hereby authorized and directed to take such additional steps and execute such additional documents as may be necessary or desirable for the completion of the Transaction and for the conveyance to the Purchaser of the Assets described in the Sale Agreement (the "**Purchased Assets**"), including the execution of ancillary documents.

3. Upon delivery by the Monitor to the Purchaser of a certificate substantially in the form attached as **Schedule "C"** hereto (the "**Monitor's Certificate**"), all of the Seller's right, title and interest in and to the Purchased Assets (other than the Cash Collateral under the Cash Collateral Agreement in circumstances where the Financial Assurances (defined below) have not been returned to the LOC Issuer marked cancelled prior to the Closing Date) described in the Sale Agreement shall vest absolutely in the Purchaser free and clear of and from any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise, other than the Indemnification Security Interest Charge (as defined below) (collectively, the "**Claims**") including, without limiting the generality of the foregoing: (i) the Administration Charge, the Directors' Charge, the KERP Charge, the Success Fee Charge, and the Intercompany Charge (each as defined in the Initial Order or the Order of this Court dated January 5, 2016, as applicable); (ii) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* of British Columbia or any other personal property registry system; and (iii) those Claims listed on **Schedule "D"** hereto (all of which are collectively referred to as the "**Encumbrances**", which term shall not include the Permitted Encumbrances (as defined in the Sale Agreement), the permitted encumbrances, easements and restrictive covenants listed on **Schedule "E"** hereto or the Indemnification Security Interest Charge as set out herein), and, for greater certainty, this

Court orders that all of the Encumbrances affecting or relating to the Purchased Assets are hereby expunged and discharged as against the Purchased Assets (other than the Cash Collateral under the Cash Collateral Agreement in circumstances where the Financial Assurances have not been returned to the LOC Issuer marked cancelled prior to the Closing Date).

4. Upon the delivery of the Monitor's Certificate to the Purchaser, the Seller is hereby granted a charge on the Real Property Assets (including any coal leases) and the Mineral Tenures (including all accretions, substitutions, replacements, additions and accessions to any of them and all proceeds of any of the foregoing) (collectively the "**Indemnification Assets**") in the amount of $100,000,000 to secure the Purchaser's indemnification obligations to the Seller under the Sale Agreement and the Contract Mining Agreement (the "**Indemnification Security Interest Charge**"). The Indemnification Security Interest Charge shall constitute a mortgage, security interest, assignment by way of security and charge on the Indemnification Assets and shall rank in priority to all other security interests, trusts, liens, mortgages, charges, and encumbrances. Any security documentation evidencing, or the filing, registration or perfection of, the Indemnification Security Interest Charge shall not be required, and the Indemnification Security Interest Charge shall be effective as against the Indemnification Assets and shall be valid and enforceable for all purposes, including as against any right, title or interest filed, registered or perfected subsequent to the Indemnification Security Interest Charge coming into existence, notwithstanding any failure to file, register or perfect the Indemnification Security Interest Charge.

5. Upon the Seller's and the Monitor's receipt from the Purchaser of a certificate certifying that (i) all Transfer Approvals and Permits contemplated under the Sale Agreement and any Ancillary Agreements have been transferred or issued, as applicable, to the Purchaser, and (ii) there have been no incidents, violations or occurrences during the term of the Contract Mining Agreement that may give rise to a claim by the Purchaser against the Seller (the **"Purchaser's Certificate**"), the Monitor shall thereafter, and following satisfaction by the Monitor that there have been no incidents, violations or occurrences during the term of the Contract Mining Agreement that may give rise to a claim by the Seller against the Purchaser, deliver a second Monitor's certificate to the Purchaser substantially in the form attached as **Schedule "F"** hereto (the "**Second Monitor's Certificate**") certifying that it has received the Purchaser's Certificate. Upon the delivery of the Second Monitor's Certificate, the Indemnification Security Interest Charge shall be extinguished.

6. Upon presentation for registration in the Land Title Office for the Land Title District of Prince George of a certified copy of this Order and the Monitor's Certificate, the British Columbia Registrar of Land Titles (the "**BC Registrar**") is hereby directed to:

   (a) enter the Purchaser as the owner of the Owned Real Property, as identified in **Schedule "G"** hereto, together with all buildings and other structures, facilities and improvements located thereon and fixtures, systems, interests, licenses, rights, covenants, restrictive covenants, commons, ways, profits, privileges, rights, easements and appurtenances to the said hereditaments belonging, or with the same or any part thereof, held or enjoyed or appurtenant thereto, in fee simple in respect of the Owned Real Property, and this Court declares that it has been proved to the satisfaction of the Court on investigation that the title of the Purchaser in and to the Owned Real Property is a good, safe holding and marketable title and directs the BC Registrar to register indefeasible title in favour of the Purchaser as aforesaid; and

(b) having considered the interest of third parties, to discharge, release, delete and expunge from title to the Owned Real Property all of the registered Encumbrances except for those listed in **Schedule "E"**.

7. Upon presentation of a certified copy of this Order and the Monitor's Certificate, the relevant mining recorders of British Columbia are directed to enter the Purchaser as the owner of the relevant Purchased Assets and enter a notation that all Encumbrances (excluding for greater certainty the Permitted Encumbrances and the Indemnification Security Interest Charge) are expunged and discharged from the Purchased Assets as at the date of the Monitor's Certificate.

8. For the purposes of determining the nature and priority of Claims, the net proceeds from the sale of the Purchased Assets shall stand in the place and stead of the Purchased Assets, and from and after the delivery of the Monitor's Certificate, all Claims shall attach to the net proceeds from the sale of the Purchased Assets with the same priority as they had with respect to the Purchased Assets immediately prior to the sale, as if the Purchased Assets had not been sold and remained in the possession or control of the person having had possession or control immediately prior to the sale.

9. The Monitor is to file with the Court a copy of the Monitor's Certificate and the Monitor's Second Certificate forthwith after the respective delivery thereof.

10. Pursuant to Section 7(3)(c) of the Canada *Personal Information Protection and Electronic Documents Act* or Section 18(10)(o) of the *Personal Information Protection Act* of British Columbia, the Seller and the Monitor are hereby authorized and permitted to disclose and transfer to the Purchaser all human resources and payroll information in the Seller's records pertaining to the Seller's past and current employees, including personal information of those employees listed in Schedule 5.9.1 to the Sale Agreement, and all previous such disclosure is hereby ratified and approved. The Purchaser shall maintain and protect the privacy of such information and shall be entitled to use the personal information provided to it in a manner which is in all material respects identical to the prior use of such information by the Seller.

11. Subject to the terms of the Sale Agreement, vacant possession of the Purchased Assets (other than the Cash Collateral under the Cash Collateral Agreement in circumstances where the Financial Assurances have not been returned to the LOC Issuer marked cancelled prior to the Closing Date), including any Real Property, shall be delivered by the Seller to the Purchaser at 12:00 noon on the Closing Date (as defined in the Sale Agreement), subject to the Permitted Encumbrances as set out in the Sale Agreement and listed on **Schedule "E"**.

12. The Seller, with the consent of the Purchaser, shall be at liberty to extend the Closing Date to such later date as those parties may agree without the necessity of a further Order of this Court.

13. Notwithstanding:

(a) these proceedings;

(b) any applications for a bankruptcy order in respect of any member of the Walter Canada Group now or hereafter made pursuant to the *Bankruptcy and Insolvency Act* and any bankruptcy order issued pursuant to any such applications; and

(c) any assignment in bankruptcy made by or in respect of any member of the Walter Canada Group,

the vesting of the Purchased Assets in the Purchaser pursuant to this Order (which, for greater certainty, shall be subject to the Indemnification Security Interest Charge) shall be binding on any trustee in bankruptcy that may be appointed in respect of any member of the Walter Canada Group and shall not be void or voidable by creditors of the Walter Canada Group, nor shall it constitute or be deemed to be a transfer at undervalue, fraudulent preference, assignment, fraudulent conveyance or other reviewable transaction under the *Bankruptcy and Insolvency Act* or any other applicable federal or provincial legislation, nor shall it constitute oppressive or unfairly prejudicial conduct pursuant to any applicable federal or provincial legislation.

14. Nothing in this Order exempts or relieves the Seller or the Purchaser from obtaining any consents, approvals or giving any notices required under any of the Permits, water rights, Mineral Tenures, Consents, coal leases or licences or any Leases from a Government Entity (collectively, the "**Authorizations**") or any enactment of the Province of British Columbia in connection with any transfer or assignment of any of the Authorizations or the issuance of any new Authorization as contemplated in the Sale Agreement or this Order or makes any of the Authorizations transferable or assignable if any of the Authorizations or new Authorizations are not, by virtue of an enactment of the Province of British Columbia or the Authorization itself, transferable, assignable or issuable, as the case may be. Notwithstanding any other provision of this Order, the transfer or assignment of any of the Authorizations or issuance of any new Authorization that

requires any such consent or approval is not effective unless and until such consent or approval is obtained.

LETTERS OF CREDIT AND CASH COLLATERAL

15. The letters of credit issued by the LOC Issuers to various Government Entities on behalf of members of the Walter Canada Group (as more fully described in the Sale Agreement, the "**Financial Assurances**") and the Cash Collateral in respect of such Financial Assurances shall be dealt with as follows:

(a) If the Purchaser has not, on or prior to the Closing Date, replaced all of the existing Financial Assurances provided to the applicable Government Entity with appropriate financial assurances in respect of the Authorizations that is satisfactory to the applicable Government Entity (which, for greater certainty, if so agreed among the Seller, the Purchaser, the applicable Government Entity and the LOC Issuer, may be satisfied by the delivery of the Cash Collateral to the applicable Government Entity), then the following steps shall occur in the following order:

(i) On Closing, the LOC Issuer and the Agent (as defined in the Order of this Court dated January 5, 2016) shall be granted a first-priority charge on the Cash Collateral ranking in priority to all other security interests, trusts, liens, mortgages, charges, and encumbrances and the Charges (as defined in the Order of this Court dated January 5, 2016) to secure the obligations of the Walter Canada Group to the LOC Issuer, the Agent and the other lenders in respect of the Financial Assurances (the "**LOC Charge**");

(ii) on the Business Day following the Closing Date, the Monitor shall pay a portion of the Cash Purchase Price equal to the amount of the Cash Collateral, less the amount of any Financial Assurance that has been replaced on or prior to the Closing Date, to the applicable Government Entity to replace the existing Financial Assurance and such amount shall be and become financial assurances in respect of the Authorizations and shall stand in the place and stead of such Financial Assurances in all respects (the "**New Financial Assurances**") and the New Financial Assurances shall be free and clear from any and all security interests (whether contractual, statutory or otherwise), hypothecs, mortgages, trusts, or deemed trusts (whether contractual, statutory or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise, including, without limiting the generality of the foregoing:

(i) the Administration Charge, the Directors' Charge, the KERP Charge, the Success Fee Charge, the Intercompany Charge, the Indemnification Security Interest Charge and the liens, security, charges and security interests in favour of the Agent; (ii) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* of British Columbia or any other personal property registry system. The applicable Government Entity shall pay such portion of New Financial Assurances to the Purchaser upon delivery to the applicable Government Entity of financial assurances in respect of the applicable Authorizations that is satisfactory to the applicable Government Entity;

(iii) the Financial Assurances issued by the LOC Issuers to various Government Entities on behalf of members of the Walter Canada Group shall be and are hereby deemed to be cancelled, released, terminated and extinguished without any further act by any Person;

(iv) the applicable Government Entity shall surrender and return to the LOC Issuer, with a copy to the Seller and to the Monitor, each outstanding Financial Assurance marked as cancelled (such delivery to occur as soon as reasonably practicable after receipt of the New Financial Assurance and in any event no later than 3 Business Days following the receipt of the New Financial Assurance);

(v) No later than one Business Day following the receipt of such Financial Assurances by the LOC Issuer in accordance with paragraph 15(a)(iv), and upon payment of all outstanding fees owing to the LOC Issuer and the Agent in respect of the Financial Assurances under the Cash Collateral Agreement, the LOC Charge shall be discharged and shall cease to be effective, the LOC Issuer shall give and shall be deemed to have given any consent required in respect of withdrawals of Cash Collateral under the Cash Collateral Agreement; the LOC Issuers shall release and shall be deemed to have released the Cash Collateral to the Monitor on behalf of the Seller; paragraph 19 of the Order of this Court dated January 5, 2016 and paragraph 13 of the Initial Order shall cease to be effective; and the Administration Charge, the Directors' Charge, the KERP Charge, the Success Fee Charge and the Intercompany Charge shall apply and shall have the priority set out in paragraph 21 of Order of this Court dated January 5, 2016.

(b) If the Purchaser has, on or prior to the Closing Date, replaced all of the existing Financial Assurances provided to the applicable Government Entity with appropriate financial assurances in respect of the Authorizations that is satisfactory to the applicable

Government Entity and the Cash Collateral has not yet been transferred, then the following steps shall occur in the following order:

(i) the Financial Assurances issued by the LOC Issuers to various Government Entities on behalf of members of the Walter Canada Group shall be and are hereby deemed to be cancelled, released, terminated and extinguished without any further act by any Person;

(ii) if each of the Financial Assurances issued by the LOC Issuers have not already been returned to the LOC Issuers, the applicable Government Entity shall surrender and return to the LOC Issuer, with a copy to the Seller and to the Monitor, each outstanding Financial Assurance marked as cancelled (such delivery to occur on Closing or as soon as reasonably practicable after Closing and in any event no later than 3 Business Days following the Closing Date);

(iii) No later than one Business Day following the receipt of such Financial Assurances by the LOC Issuer in accordance with paragraph 15(b)(ii), and upon payment of all outstanding fees owing to the LOC Issuer and the Agent in respect of the Financial Assurances under the Cash Collateral Agreement, the LOC Issuer shall give and shall be deemed to have given any consent required in respect of withdrawals of Cash Collateral under the Cash Collateral Agreement; the Cash Collateral held by the LOC Issuers and posted by members of the Walter Canada Group shall be transferred and delivered by the LOC Issuers to the Purchaser or as the Purchaser shall direct; and paragraph 19 of the Order of this Court dated January 5, 2016 and paragraph 13 of the Initial Order shall cease to be effective.

(c) Until the surrender and return to the LOC Issuer of each original Financial Assurance, the provisions of the Cash Collateral Agreement shall apply, including without limitation, the right of the LOC Issuer to apply the Cash Collateral to reimburse itself for any drawing.

(d) The provisions of this paragraph 15 shall (i) satisfy the Seller's obligation in section 5.3.7 of the Sale Agreement to cause the Financial Assurances to remain in place; (ii) be the Court Order contemplated by section 5.3.8 of the Sale Agreement; and (iii) shall stand in the place and stead of any Cash Collateral Transfer Agreement contemplated by the Sale Agreement. To the extent there is a conflict between the APA and this Order, this Order shall govern.

GENERAL

16. Endorsement of this Order by counsel appearing, other than counsel for the Walter Canada Group, is hereby dispensed with.

THIS COURT REQUESTS the aid and recognition of other Canadian and foreign Courts, tribunals, regulatory or administrative bodies, including any Court or administrative tribunal of any federal or State Court or administrative body in the United States of America, to act in aid of and to be complementary to this Court in carrying out the terms of this Order where required. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Walter Canada Group and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Walter Canada Group and the Monitor and their respective agents in carrying out the terms of this Order.

THE FOLLOWING PARTIES APPROVE THE FORM OF THIS ORDER AND CONSENT TO EACH OF THE ORDERS, IF ANY, THAT ARE INDICATED ABOVE AS BEING BY CONSENT:

Lawyers for the Petitioners

DLA Piper (Canada) LLP
(Mary I.A. Buttery and H. Lance Williams)

and

Osler, Hoskin & Harcourt LLP
(Marc Wasserman and Patrick Riesterer)

BY THE COURT

REGISTRAR

SCHEDULE "A"

Petitioners

1. Walter Energy Canada Holdings, Inc.

2. Walter Canadian Coal ULC

3. Brule Coal ULC

4. Willow Creek Coal ULC

5. Wolverine Coal ULC

6. Cambrian Energybuild Holdings ULC

7. Pine Valley Coal Ltd.

8. 0541237 B.C. Ltd.

Partnerships

9. Walter Canadian Coal Partnership

10. Brule Coal Partnership

11. Willow Creek Coal Partnership

12. Wolverine Coal Partnership

SCHEDULE "B"

Counsel List	
Name	**Party Represented**
Kathryn Esaw Angela Crimeni	Canadian Counsel for Morgan Stanley Senior Funding, Inc., as Administrative Agent and Collateral Agent under the First Lien Credit Facility
John Sandrelli Tevia Jeffries	UMWA 1974 Pension Plan and Trust
Heather L. Jones	Kevin James
Aaron Welch	Her Majesty the Queen in right of British Columbia
Craig Bavis Stephanie Drake	USW, Local 1-424
Kieran Siddall	Pine Valley Mining Corporation
David Wachowich Leanne Krawchuck (by phone)	Conuma Coal Resources Limited

SCHEDULE "C"

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*,
S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT
OF WALTER ENERGY CANADA HOLDINGS, INC., AND THE OTHER PETITIONERS
LISTED ON SCHEDULE "A"

PETITIONERS

MONITOR'S CERTIFICATE

1. Pursuant to an Order of the Court dated ●, 2016 (the "**Approval and Vesting Order**"), the Court approved the Asset Purchase Agreement dated ●, 2016 (the "**Sale Agreement**") between Walter Energy Canada Holdings, Inc., and the other entities listed in Schedule A thereto (collectively, the "**Seller**"), Conuma Coal Resources Limited (the "**Purchaser**") and the Guarantors party thereto (collectively, the "**Parties**"), and ordered that all of the Seller's right, title and interest in and to the Assets, vest in the Purchaser (subject to the Indemnification Security Interest Charge) effective upon the delivery by KPMG Inc., in its capacity as the Court-appointed Monitor of the Walter Canada Group (the "**Monitor**") of this certificate to the Purchaser confirming: (i) payment by the Purchaser and receipt by the Monitor of the Cash Purchase Price in relation to the purchase by the Purchaser of the Assets; (ii) that the conditions to be complied with at or prior to the Closing as set out in **[Article 5 and Article 7]**, respectively, of the Sale Agreement have been satisfied or waived by the Seller or the Purchaser, as applicable; and (iii) the purchase and sale of the Assets has been completed pursuant to the Sale Agreement.

2. Unless otherwise defined herein, capitalized terms shall have the meanings ascribed to them in the Sale Agreement.

THE MONITOR HEREBY CERTIFIES as follows:

(a) The Purchaser has paid and the Monitor has received the Cash Purchase Price in relation to the purchase by the Purchaser of the Assets;

(b) The conditions to be complied with at or prior to the Closing as set out in **[Article 5 and Article 7]**, respectively, of the Sale Agreement have been satisfied or waived by the Seller or the Purchaser, as applicable; and

(c) The purchase and sale of the Assets has been completed pursuant to the Sale Agreement.

DATED at the City of Vancouver, in the Province of British Columbia, this ______ day of _________, **[2016.]**

KPMG INC., in its capacity as the Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.* and not in its personal or corporate capacity

By:

____
Name:
Title:

SCHEDULE "D"

ENCUMBRANCES TO BE DISCHARGED

None

SCHEDULE "E"

PERMITTED ENCUMBRANCES

WALTER CANADA GROUP OWNER	Wolverine Coal ULC	Willow Creek Coal ULC
PARCEL IDENTIFIER	026-373-840	024-621-552
LEGAL DESCRIPTION	LOT 1 EXCEPT: PART DEDICATED FOREST SERVICE ROAD ON PLAN BCP19871; DISTRICT LOTS 305 AND 306 PEACE RIVER DISTRICT PLAN BCP19069	LOT 1 DISTRICT LOT 1149 PEACE RIVER DISTRICT PLAN PGP44780
PERMITTED ENCUMBRANCES	#1: Nature: OPTION TO PURCHASE Registration Number: BX195552 Registration Date and Time: 2005-09-21 14:48 Registered Owner: MARY ANN EYBEN ARDITH NADINE BOOI EXECUTORS OF THE WILL OF JOHN WESLEY TERRY DECEASED SEE PS8845 #2 Nature: CLAIM OF BUILDERS LIEN Registration Number: CA3563886 Registration Date and Time: 2014-01-24 15:41 Registered Owner: CORDY CONSTRUCTION INC.	#1: Nature: U. AND E & R Registration Number: W32996 Registration Date and Time: 1985-11-07 09:07 Registered Owner: HER MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF BRITISH COLUMBIA Remarks: INTER ALIA SEE W32994 SECTION 47 LAND ACT #2: Nature: COVENANT Registration Number: PN40827 Registration Date and Time:

	INCORPORATION NO. BC0989644 Remarks: INTER ALIA	1999-10-28 09:41 Registered Owner: THE CROWN IN RIGHT OF BRITISH COLUMBIA AS REPRESENTED BY THE MINISTRY OF ENVIRONMENT LANDS AND PARKS PEACE RIVER REGIONAL DISTRICT Remarks: INTER ALIA #3: Nature: COVENANT Registration Number: PN40828 Registration Date and Time: 1999-10-28 09:41 Registered Owner: PEACE RIVER REGIONAL DISTRICT Remarks: INTER ALIA

SCHEDULE "F"

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*,
S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT
OF WALTER ENERGY CANADA HOLDINGS, INC., AND THE OTHER PETITIONERS
LISTED ON SCHEDULE "A"

PETITIONERS

SECOND MONITOR'S CERTIFICATE

1. Pursuant to an Order of the Court dated ●, 2016 (the "**Approval and Vesting Order**"), the Court approved the Asset Purchase Agreement dated ●, 2016 (the "**Sale Agreement**") between Walter Energy Canada Holdings, Inc., and the other entities listed in Schedule A thereto (collectively, the "**Seller**"), Conuma Coal Resources Limited (the "**Purchaser**") and the Guarantors party thereto (collectively, the "**Parties**"), and ordered that upon the Seller's and the Monitor's receipt from the Purchaser of a certificate certifying that (i) all Transfer Approvals and Permits contemplated under the Sale Agreement and any Ancillary Agreements have been transferred or issued, as applicable, to the Purchaser, and (ii) there have been no incidents, violations or occurrences during the term of the Contract Mining Agreement that may give rise to a Claim against the Seller (the "**Purchaser's Certificate**"), the Monitor shall thereafter, and following satisfaction by the Monitor that there have been no incidents, violations or occurrences during the term of the Contract Mining Agreement that may give rise to a claim by the Seller against the Purchaser, deliver this second Monitor's certificate to the Purchaser certifying that it received the Purchaser's Certificate and the Indemnification Security Interest Charge shall be extinguished.

2. Unless otherwise defined herein, capitalized terms shall have the meanings ascribed to them in the Sale Agreement.

THE MONITOR HEREBY CERTIFIES as follows:

(a) The Monitor has received the Purchaser's Certificate;

(b) The Monitor is not aware of any incidents, violations or occurrences during the term of the Contract Mining Agreement that may give rise to a claim by the Seller against the Purchaser; and

(c) The Indemnification Security Interest Charge shall be extinguished.

DATED at the City of Vancouver, in the Province of British Columbia, this ______ day of _________, **[2016.]**

KPMG INC., in its capacity as the Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.* and not in its personal or corporate capacity

By: ________________________________

Name:
Title:

SCHEDULE "G"

OWNED REAL PROPERTY

WALTER CANADA GROUP OWNER	PARCEL IDENTIFIER	LEGAL DESCRIPTION
Wolverine Coal ULC	026-373-840	LOT 1 EXCEPT: PART DEDICATED FOREST SERVICE ROAD ON PLAN BCP19871; DISTRICT LOTS 305 AND 306 PEACE RIVER DISTRICT PLAN BCP19069
Wolverine Coal ULC	005-329-949	LOT 92 DISTRICT LOT 3164 PEACE RIVER DISTRICT PLAN 30292
Wolverine Coal ULC	006-033-571	LOT 56 DISTRICT LOT 3164 PEACE RIVER DISTRICT PLAN 28295
Wolverine Coal ULC	006-035-191	LOT 129 DISTRICT LOT 3164 PEACE RIVER DISTRICT PLAN 28289
Wolverine Coal ULC	006-001-319	LOT 12 DISTRICT LOT 3164 PEACE RIVER DISTRICT PLAN 28295
Wolverine Coal ULC	006-028-233	LOT 49 DISTRICT LOT 3164 PEACE RIVER DISTRICT PLAN 28289
Wolverine Coal ULC	005-624-568	LOT 72 DISTRICT LOT 3164 PEACE RIVER DISTRICT PLAN 29399
Willow Creek Coal ULC	024-621-552	LOT 1 DISTRICT LOT 1149 PEACE RIVER DISTRICT PLAN PGP44780
Willow Creek Coal ULC	006-200-605	LOT A DISTRICT LOT 1807 PEACE RIVER DISTRICT PLAN 27989

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*, S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT OF WALTER ENERGY CANADA HOLDINGS, INC., AND THOSE PARTIES LISTED ON SCHEDULE "A"

PETITIONERS

ORDER MADE AFTER APPLICATION

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Client Matter No. 15375-00001 TAG/mlf

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TAB 118

SUPREME COURT
OF BRITISH COLUMBIA
VANCOUVER REGISTRY

AUG 16 2016

ENTERED

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*,
S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT
OF WALTER ENERGY CANADA HOLDINGS, INC., AND THE OTHER PETITIONERS
LISTED ON SCHEDULE "A" TO THE INITIAL ORDER

PETITIONERS

ORDER MADE AFTER APPLICATION
(CLAIMS PROCESS ORDER)

BEFORE THE HONOURABLE	)	TUESDAY, THE 16TH DAY OF
MADAM JUSTICE FITZPATRICK	))	AUGUST, 2016

ON THE APPLICATION of the Petitioners coming on for hearing at Vancouver, British Columbia, on the 15th and 16th day of August, 2016; AND ON HEARING Mary I.A. Buttery, H. Lance Williams, Marc S. Wasserman and Patrick Riesterer, counsel for the Petitioners and the Partnerships listed on Schedule "A" and Schedule "C" of the Initial Order (collectively, the "**Walter Canada Group**"), Peter Reardon and Wael Rostom, counsel for KPMG Inc. and those other counsel listed on Schedule "A" hereto; AND UPON READING the material filed, including the Third Affidavit of William E. Aziz sworn August 9, 2016 and the Fourth Report of the Monitor dated August 11, 2016;

THIS COURT ORDERS AND DECLARES THAT:

DEFINITIONS AND INTERPRETATION

1. All capitalised terms not otherwise defined in this Claims Process Order shall have the definitions set out in Schedule "B" hereto.

2. All references herein to time shall mean local time in Vancouver, British Columbia, Canada, and any reference to an event occurring on a Business Day shall mean prior to 5:00 p.m. on such Business Day unless otherwise indicated herein and any event that occurs on a day that is not a Business Day shall be deemed to occur on the next Business Day.

3. All references to the word "including" shall mean "including, without limitation."

4. All references to the singular herein include the plural, the plural include the singular and any gender includes all genders.

GENERAL PROVISIONS

5. The Claims Process, including the Claims Bar Date and the Restructuring Claims Bar Date is hereby approved.

6. The Monitor, in consultation with the Walter Canada Group, is hereby authorised to use reasonable discretion as to the adequacy of compliance with respect to the manner in which forms delivered hereunder are completed and executed and the time in which they are submitted and may, where it is satisfied that a Claim has been adequately proven, waive strict compliance with the requirements of this Claims Process Order, including in respect of the completion, execution and time of delivery of such forms, and may request any further documentation from a Claimant that the Monitor, in consultation with the Walter Canada Group, may determine is necessary or desirable in order to enable it to determine the validity of a Claim.

7. If any Claim arose in a currency other than Canadian dollars, then the Person making the Claim shall complete its Proof of Claim, indicating the amount of the Claim in such currency, rather than in Canadian dollars or any other currency. Where no currency is indicated, the Claim shall be presumed to be in Canadian dollars. The Monitor shall subsequently calculate the amount of such Claim in Canadian Dollars, using the Reuters closing rate on the Commencement Date (as found at http://www.reuters.com/finance/currencies).

8. Copies of all forms delivered by or to a Claimant hereunder, as applicable, and determinations of Claims by the Monitor or the Court, as the case may be, shall be maintained by the Monitor and, subject to further order of the Court, such Claimant will be entitled to have access in relation to their respective Claim by appointment during normal business hours on written request to the Monitor.

MONITOR'S ROLE

9. The Monitor, in addition to its prescribed rights, duties, responsibilities and obligations under the CCAA, the Initial Order and any other Orders of the Court in the CCAA Proceeding, is hereby directed and empowered to implement the Claims Process set out herein, including the determination of Claims of Claimants and the referral of any Claim to the Court and to take such other actions and fulfill such other roles as are authorized by this Claims Process Order or incidental thereto.

10. The Monitor shall: (i) have all of the protections given to it by the CCAA, the Initial Order, any other Orders of the Court in the CCAA Proceeding, and this Claims Process Order, and as an officer of the Court, including the stay of proceedings in its favour; (ii) incur no liability or obligation as a result of

the carrying out of the provisions of this Claims Process Order; (iii) be entitled to rely on the books and records of the Walter Canada Group and any information provided by the Walter Canada Group and the CRO (as defined herein), all without independent investigation; and (iv) not be liable for any claims or damages resulting from any errors or omissions in such books, records or information.

11. Consultation with the Court-appointed Chief Restructuring Officer of the Walter Canada Group, William E. Aziz of BlueTree Advisors Inc. (the "**CRO**"), shall satisfy any obligation of the Monitor in this Claims Process Order to consult with the Walter Canada Group.

12. [Intentionally Deleted.]

13. The Monitor, exercising its reasonable judgement may schedule a motion with the Court on notice to the Service List to seek approval of a process for the resolution of any dispute in connection with the Intercompany Claims and any other disputes of Claimants and related motions, including a process regarding requests for the production of documents or any oral examinations.

14. The Monitor shall file a report with the Court as soon as practicable following the Claims Bar Date (and serve such report on the Service List) detailing the nature and quantum of all Claims filed or determined in accordance with this Order and the status thereof, including the nature and quantum of any Intercompany Claims.

NOTICE OF CLAIMS

15. Forthwith after this Claims Process Order, and in any event within seven (7) Business Days following the date of this Claims Process Order, the Monitor shall cause a Claims Package to be sent to:

(a) Each known Claimant with a Claim as evidenced in the books and records of the Walter Canada Group as of the Commencement Date in accordance with paragraph **42** of this Claims Process Order; and

(b) Each party having provided contact information to the Service List.

16. The Claims Package sent by the Monitor to each Employee Claimant shall include (i) a Notice of Employee Claim that sets out the amount of such Employee Claimant's Employee Claim as determined by the Monitor (in consultation with the Walter Canada Group) and as evidenced by the books and records of the Walter Canada Group and the identity of the Walter Canada Group entity liable for such Employee Claim and (ii) a blank Notice of Dispute of Employee Claim. Where an Employee Claimant is represented by the United Steelworkers, a copy of the Notice of Employee Claim will be provided to the United Steelworkers.

17. Forthwith after this Claims Process Order, and in any event within ten (10) Business Days following the date of this Claims Process Order, the Monitor shall cause the Newspaper Notice to be

published for one (1) Business Day in the Globe and Mail (National Edition), the Vancouver Sun, the Chetwynd Echo and the Tumbler Ridge News.

18. Forthwith after the date of this Claims Process Order and in any event within five (5) Business Days following the date of this Claims Process Order, the Monitor shall post on the Monitor's Website a copy of this Claims Process Order, a blank Proof of Claim form, the Instruction Letter and a blank Notice of Dispute form.

19. To the extent that any Claimant requests documents relating to the Claims Process prior to the Claims Bar Date or the Restructuring Claims Bar Date, as applicable, or the Monitor becomes aware of any further Claimants, the Monitor shall forthwith cause a Claims Package to be sent to the Claimant, direct the Claimant to the documents posted on the Monitor's Website, and otherwise respond to the request relating to the Claims Process as may be appropriate in the circumstances.

20. Subject to further order of the Court, any Notice of Disclaimer or Resiliation issued by a member of the Walter Canada Group must be issued by such Walter Canada Group entity at least fifteen (15) days prior to a scheduled Meeting Date, if any, or any adjournment thereof. Any Notice of Disclaimer or Resiliation delivered to a Person after the date of this Claims Process Order shall be accompanied by a Claims Package.

NOTICE SUFFICIENT

21. The forms of Instruction Letter, Employee Claim Amount Notice, Proof of Claim, Notice of Dispute of Employee Claim, Notice of Revision or Disallowance, Notice of Dispute and Newspaper Notice substantially in the forms attached to this Claims Process Order as Schedules "C", "D", "E", "F", "G", "H" and "I", respectively, are hereby approved. Schedule "J", Walter Canada Claims Process Key Dates, is also approved. Despite the forgoing, the Monitor, in consultation with the Walter Canada Group, may, from time to time, make minor changes to such forms as the Monitor, in consultation with the Walter Canada Group, may consider necessary or desirable and may make such changes to the key dates as are permitted pursuant to the terms hereof.

22. Publication of the Newspaper Notice, the mailing to the known Claimants of a Claims Package in accordance with this Claims Process Order, the mailing to Employee Claimants of the Employee Claim Amount Notices and completion of the other requirements of this Claims Process Order shall constitute good and sufficient service and delivery of notice of this Claims Process Order, the Claims Bar Date and the Restructuring Claims Bar Date on all Persons who may be entitled to receive notice and who may wish to assert a Claim, and no other notice or service need be given or made and no other document or material need be sent to or served upon any Person in respect of this Claims Process Order.

FILING PROOFS OF CLAIM FOR CLAIMS OTHER THAN RESTRUCTURING CLAIMS

23. Subject to paragraphs **25** and **28** hereof, any Claimant who wishes to assert a Claim (other than a Restructuring Claim) against any of the members of the Walter Canada Group and/or any Director and/or Officer shall file a Proof of Claim with the Monitor in the manner set out in paragraph **43** hereof so that the Proof of Claim is received by the Monitor by no later than the Claims Bar Date.

24. Subject to paragraphs **25** and **28** hereof, any Person who does not file a Proof of Claim as provided for in paragraph **23** hereof so that such Proof of Claim is received by the Monitor on or before the Claims Bar Date, or such later date as the Monitor, in consultation with the Walter Canada Group, may agree in writing or the Court may otherwise direct, shall:

(a) be and is hereby forever barred, estopped and enjoined from asserting or enforcing any Claim against any of the Walter Canada Group entities and/or any of the Directors and/or Officers and all such Claims shall forever be extinguished;

(b) not be permitted to vote on any Plan on account of such Claim;

(c) not be permitted to participate in any distribution under the Plan, from the proceeds of any sale of the Walter Canada Group's assets or otherwise on account of such Claim(s); and

(d) not be entitled to receive further notice in respect of the Claims Process, these CCAA Proceedings or the Meeting Dates.

25. Notwithstanding paragraphs **23** and **24** hereof, any Employee Claimant who receives an Employee Claim Amount Notice and who does not dispute the Employee Claim as set forth in the Employee Claim Amount Notice is not required to file a Proof of Claim by the Claims Bar Date. If an Employee Claimant who receives an Employee Claim Amount Notice does not file a Notice of Dispute of Employee Claim by the Claims Bar Date, then the Employee Claim as set out in such Employee Claimant's Employee Claim Amount Notice shall be such Employee's Allowed Claim for voting and distribution purposes. For the purposes of their Employee Claim, if the Monitor determines, in its discretion, that the Claims Process would be furthered thereby, all unionized Employees who have not yet been terminated as of the date of this Order shall be deemed to have been terminated as of the date of this Order solely for the purpose of calculating the value of their Employee Claim; provided, however, that nothing in this Order affects the rights of those unionized employees under their collective agreement or the operation of s. 35 of the *Labour Relations Code.*

26. Any Employee Claimant who receives an Employee Claim Amount Notice and wishes to dispute the amount set out therein shall file a Notice of Dispute of Employee Claim with the Monitor in the manner

set out in paragraph **43** hereof so that the Notice of Dispute of Employee Claim is received by the Monitor by no later than the Claims Bar Date.

27. Notwithstanding anything contained in this Claims Process Order, Unaffected Claims shall not be extinguished or affected by this Claims Process Order and, for greater certainty, paragraph **24** shall not apply to the Unaffected Claims.

FILING PROOFS OF CLAIM FOR RESTRUCTURING CLAIMS

28. Notwithstanding paragraphs **23** and **24** hereof, any Claimant who wishes to assert a Restructuring Claim against any member of the Walter Canada Group and/or any Director and/or Officer shall file a Proof of Claim with the Monitor in the manner set out in paragraph **43** hereof so that the Proof of Claim is received by the Monitor no later than the Restructuring Claims Bar Date. All other dates contained herein (other than the Claims Bar Date), shall apply equally to any Restructuring Claims.

29. Any Person that does not file a Proof of Claim in respect of a Restructuring Claim as provided for in paragraph **28** hereof, so that the Proof of Claim is received by the Monitor on or before the Restructuring Claims Bar Date, or such later date as the Monitor, in consultation with the Walter Canada Group, may agree in writing or the Court may otherwise direct, shall:

(a) be and is hereby forever barred, estopped and enjoined from asserting or enforcing any Restructuring Claim against any of the Walter Canada Group entities and/or any of the Directors and/or Officers and all such Restructuring Claims shall be forever extinguished;

(b) not be permitted to vote on the Plan on account of such Restructuring Claim(s);

(c) not be permitted to participate in any distribution under any Plan, from the proceeds of any sale of the Walter Canada Group's assets or otherwise on account of such Restructuring Claim(s); and,

(d) not be entitled to receive further notice in respect of the Claims Process, these CCAA Proceedings or the Meeting Dates (unless such Person is also a Claimant with a Claim other than such Restructuring Claim entitling such Person to further notice in these proceedings).

UMWA 1974 PENSION PLAN CLAIMS

30. Notwithstanding any other provision of this Claims Process Order, the UMWA 1974 Pension Plan Claim shall be adjudicated by this Court under a procedure to be determined more fully by subsequent Order of this Court after completion of the following steps, which hereby are ordered to be taken:

(a) On or before August 26, 2016, the UMWA 1974 Pension Plan is authorized but not directed to file and deliver to the Service List a notice of claim substantially in Form 1 of the *Supreme Court Civil Rules*; and

(b) On or before September 26, 2016 any person on the Service List who contests the UMWA 1974 Pension Plan Claim filed pursuant to sub-paragraph **(a)** of this paragraph **30** is authorized but not directed to file and deliver to the Service List a response to notice of claim substantially in Form 2 of the *Supreme Court Civil Rules*; and

(c) On or before the Claims Bar Date, the UMWA 1974 Pension Plan may file and deliver to the Service List a reply substantially in Form 7 of the *Supreme Court Civil Rules*.

31. Promptly upon completion of sub-paragraphs **(a)**, **(b)** and **(c)** of paragraph **30** of this Claims Process Order, the Monitor shall, in consultation with counsel for the UMWA 1974 Pension Plan, seek a scheduling appointment before the Court, on notice to the Service List, to seek further directions concerning the procedure for adjudicating the UMWA 1974 Pension Plan Claim.

32. Pending the determination of the UMWA 1974 Pension Plan Claim, the UMWA 1974 Pension Plan Claim shall not be accepted or determined as Allowed Claims pursuant to this Claims Process without approval of this Court, but the UMWA 1974 Pension Plan shall have the same rights and entitlements in respect of the Claims Process as Claimants who file Proofs of Claim in accordance with paragraphs **23** or **28** hereof.

33. If the UMWA 1974 Pension Plan does not a notice of claim pursuant to sub-paragraph **(a)** of paragraph **30**, paragraph **24** hereof shall apply and the UMWA 1974 Pension Plan Claim shall be forever barred.

ADJUDICATION OF CLAIMS

34. The Monitor shall provide the Walter Canada Group's counsel with copies of all Proofs of Claim, Employee Claim Amount Notices, Notices of Dispute of Employee Claims, Notices of Dispute and any other materials delivered by or filed with the Monitor pursuant to the Claims Process. The Monitor shall grant the Walter Canada Group and its legal counsel access to a database to be created by the Monitor, which includes, among other things:

(a) a regularly updated claims register;

(b) electronic copies of all Proofs of Claim filed with the Monitor;

(c) electronic copies of all Employee Claim Amount Notices delivered by the Monitor;

(d) electronic copies of all Notices of Dispute of Employee Claims filed with the Monitor;

(e) electronic copies of all Notices of Revision or Disallowance issued by the Monitor; and,

(f) electronic copies of all Notices of Dispute filed with the Monitor.

35. The Monitor, in consultation with the Walter Canada Group, shall review all Proofs of Claim, Notices of Dispute of Employee Claim and other Claims Process materials received on or before the Claims Bar Date or the Restructuring Claims Bar Date, as applicable, and shall accept, revise or disallow each Pre-Commencement Claim, Restructuring Claim or Employee Claim, as applicable, as set out therein. If the Monitor, in consultation with the Walter Canada Group, wishes to revise or disallow a Pre-Commencement Claim, a Restructuring Claim or an Employee Claim, the Monitor shall, by no later than November 7, 2016 or thirty (30) Business Days after the Restructuring Claims Bar Date, as applicable, send such Claimant a Notice of Revision or Disallowance advising that the Claimant's Claim as set out in its Proof of Claim has been revised or disallowed and the reasons therefore. Where an Employee Claimant is represented by the United Steelworkers, a copy of the Notice of Revision of Disallowance will be provided to the United Steelworkers. If the Monitor does not send a Notice of Revision or Disallowance to a Claimant by such date or such other date as may be determined by the Monitor, in consultation with the Walter Canada Group, and on notice to the Claimant, the Claim set out in the applicable Proof of Claim shall be an Allowed Claim for voting and/or distribution purposes. Unless otherwise agreed to by the Monitor, in consultation with the Walter Canada Group, or ordered by the Court, all Claims set out in Proofs of Claim that are filed after the Claims Bar Date or the Restructuring Claims Bar Date, as applicable, are deemed to be disallowed and the Monitor need not deliver a Notice of Revision or Disallowance in respect of such Claim.

36. Any Claimant who is sent a Notice of Revision or Disallowance pursuant to paragraph **35** hereof and wishes to dispute such Notice of Revision or Disallowance shall deliver a completed Notice of Dispute to the Monitor by no later than 5:00 p.m. on the later of December 6, 2016 or the day which is twenty (20) Business Days after the date of the applicable Notice of Revision or Disallowance or such other date as may be agreed to by the Monitor. If a Claimant fails to deliver a Notice of Dispute by such date, the Claim set out in the applicable Notice of Revision or Disallowance, if any, shall be deemed to be an Allowed Claim for voting and/or distribution purposes. Where an Employee Claimant is represented by the United Steelworkers, a Notice of Dispute may be filed by the United Steelworkers and may represent the employee in the resolution of the disputed Claim.

37. Upon receipt of a Notice of Dispute, the Monitor, in consultation with the Walter Canada Group, may attempt to consensually resolve the disputed Claim.

38. If the Monitor, in consultation with the Walter Canada Group, and the Claimant consensually resolve the disputed Claim, such Claim (as resolved) shall be an Allowed Claim.

39. If the disputed Claim cannot be consensually resolved the disputing party may bring a motion on a de novo basis before the Court in these proceedings to resolve the disputed Claim by the later of January 9, 2016 and the day that is twenty (20) Business Days after the date of delivery of a Notice of Dispute, or such time as may be extended by agreement between the Claimant and the Monitor.

40. Notwithstanding any other provision of this Order, the Monitor may refer any Claim to the Court for adjudication by sending written notice to the Claimant at any time, including, for greater certainty, in lieu of sending a Notice of Revision or Disallowance to any Claimant.

NOTICE OF TRANSFEREES

41. Subject to the terms of the order fixing a Meetings Date and the Plan if, after the Commencement Date, the holder of a Claim transfers or assigns the whole of such Claim to another Person, neither the Monitor nor the Walter Canada Group shall be obligated to give notice or otherwise deal with the transferee or assignee of such Claim in respect thereof unless and until actual written notice of such transfer or assignment, together with satisfactory evidence of such transfer or assignment shall have been received and acknowledged by the relevant member of the Walter Canada Group and the Monitor in writing and the Monitor has acknowledged such transfer through written notice to the transferor and thereafter such transferee or assignee shall for the purposes hereof constitute the "Claimant" in respect of such Claim. Any such transferee or assignee of a Claim shall be bound by any notices given or steps taken in respect of such Claim in accordance with the Claims Process prior to the receipt and acknowledgement by the relevant member of the Walter Canada Group and the Monitor of the delivery of satisfactory evidence of such transfer or assignment. A transferee or assignee of a Claim takes the Claim subject to any rights of set-off to which a member of the Walter Canada Group may be entitled with respect to such Claim. For greater certainty, a transferee or assignee of a Claim is not entitled to set-off, apply, merge, consolidate or combine any Claims assigned or transferred to it against or on account or in reduction of any amounts owing by such Person to any of the Walter Canada Group entities. Reference to a transfer in this Claims Process Order includes a transfer or assignment whether absolute or intended as security.

SERVICES AND NOTICES

42. The Monitor may, unless otherwise specified by this Claims Process Order, serve and deliver the Claims Package, any Notices of Revision or Disallowance, any letters, notices or other documents to a Claimant or any other interested Person by forwarding true copies thereof by prepaid ordinary mail, courier, personal delivery, or electronic transmission to such Persons at their respective addresses or contact information as last shown on the records of the Walter Canada Group entities or set out in such Claimant's Proof of Claim. Any such service and delivery shall be deemed to have been received:

(a) If sent by ordinary mail, on the third Business Day after mailing within British Columbia, the fifth Business Day after mailing within Canada (other than British Columbia) and the seventh Business Day after mailing outside of Canada;

(b) If sent by courier or personal delivery, on the next Business Day following dispatch;

(c) If delivered by electronic transmission, by 5:00 p.m. on a Business Day on such Business Day and if delivered after 5:00 p.m. or other than a Business Day, on the following Business Day.

43. Any Proofs of Claim, Notice of Dispute of Employee Claim, Notice of Dispute or other notice or communication to be provided or delivered by a Claimant to the Monitor under this Claims Process Order, shall be in writing in substantially the form, if any, provided for in this Claims Process Order and will be sufficiently given only if delivered by prepaid registered mail, courier, personal delivery, or email addressed to:

KPMG Inc.
Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al*
777 Dunsmuir St
Vancouver, BC V7Y 1K3

Attention: Mark Kemp-Gee/Mike Clark
Email: mkempgee@kpmg.ca, maclark@kpmg.ca
Phone: 604-691-3397; 604-691-3468

Any such notice or communication delivered by a Claimant shall be deemed to be received upon actual receipt thereof by the Monitor before 5:00 p.m. (Vancouver Time) on a Business Day or, if delivered after 5:00 p.m. (Vancouver Time), on the next Business Day.

44. If during any period which notice or other communications are being given pursuant to this Claims Process Order, a postal strike or postage work stoppage of general application should occur, such notice or other communications sent by ordinary mail and then not received shall not, absent further Order of this Court, be effective, and notices and other communications given hereunder during the course of any such postage strike or work stoppage of general application shall only be effective if given by courier, personal delivery, email or posting on the Monitor's Website.

45. In the event this Claims Process Order is later amended by further Order of the Court, the Monitor may post such further Order on the Monitor's Website and serve such further Order on the Service List, and such posting and service shall constitute adequate notice to Claimants of such amended claims procedure.

MISCELLANEOUS

46. Notwithstanding any other provisions of this Claims Process Order, the solicitation by the Monitor of Proofs of Claim, and the filing by any Claimant of any Proof of Claim shall not, for that reason only, grant any Person standing in these CCAA Proceedings or rights under any proposed Plan.

47. Nothing in this Claims Process Order shall constitute or be deemed to constitute an allocation or assignment of Claims or Unaffected Claims by the Walter Canada Group into particular affected or unaffected classes for the purpose of a Plan.

48. Nothing in this Order shall prejudice the rights and remedies of any Directors, Officers, the Chief Restructuring Officer or other Persons under the Directors' Charge, any other Charge or any applicable insurance policy or prevent or bar any Person from seeking recourse against or payment from the Walter Canada Group's insurance and any Director's or Officer's liability insurance policy or policies that exist to protect or indemnify the Directors, Officers, or other Persons, whether such recourse or payment is sought directly by the Person asserting a Claim or a Directors/Officers Claim from the insurer or derivatively through the Director, Officer or any other Person, including any member of the Walter Canada Group; provided, however, that nothing in this Order shall create any rights in favour of such Person under any policies of insurance nor shall anything in this Order limit, remove, modify or alter any defence to such claim available to the insurer pursuant to the provisions of any insurance policy or at law; and further provided that any Claim or Directors/Officers Claim or portion thereof for which the Person receives payment directly from, or confirmation that she is covered by, the Walter Canada Group's insurance or any Director's or Officer's liability insurance or other liability insurance policy or policies that exist to protect or indemnify the Directors, Officers or other Persons shall not be recoverable as against the Walter Canada Group or a Director, Officer, or other Person, as applicable.

49. The Claims Bar Date and the Restructuring Claims Bar Date, and the amount and status of every Allowed Claim, as determined under the Claims Process, including any determination as to the nature, amount, value, priority or validity of any Claim, including any secured claim, shall continue in full force and effect and be final for all purposes (except as expressly stated in any Notice of Disallowance or Revision or settlement or order of the Court), including in respect of any Plan and voting thereon (unless provided for otherwise in any Order of Court), and, including for any distribution made to Claimants of any of the Walter Canada Group entities, whether in these CCAA Proceedings or in any of the proceedings authorised by this Court or permitted by statute, including a receivership proceeding or bankruptcy affecting any member of the Walter Canada Group.

50. In carrying out the terms of this Claims Process Order and aiding the Monitor in accordance with the terms of this Claims Process Order, the CRO shall:

(a) be entitled to rely on all of the protections granted to it in the SISP Order;

(b) be entitled to rely on the books and records of the Walter Canada Group entities and any information provided by the Walter Canada Group entities, all without independent investigations; and

(c) shall not be liable for any claims or damages resulting from any errors or omissions in such books, records or information.

51. Notwithstanding the terms of this Claims Process Order, the Walter Canada Group and the Monitor may apply to this Court from time to time for advice and directions from this Court with respect to this Claims Process Order, including the Claims Process and the schedules to this Claims Process Order, or for such further Order or Orders as either of them may consider necessary or desirable to amend, supplement or replace this Order, including any schedule to this Order.

APPROVAL

52. Endorsement of this Order by counsel appearing on this application is hereby dispensed with.

THIS COURT REQUESTS the aid, recognition and assistance of other Canadian and foreign Courts, tribunal, regulatory or administrative bodies, including any Court or administrative tribunal of any Federal or State Court or administrative body in the United States of America, to act in aid of and be complementary to this Court in carrying out the terms of this Claims Process Order where required. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to:

(a) make such orders and to provide such assistance to the Walter Canada Group and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Claims Process Order;

(b) grant representative status to any of the Walter Canada Group entities and the Monitor to act on behalf of any or all of the Walter Canada Group entities in any foreign proceeding; and,

(c) assist the Walter Canada Group, the Monitor and the respective agents of each of the forgoing in carrying out the terms of this Claims Process Order.

In addition, each of the Walter Canada Group entities and the Monitor shall be at liberty, and is hereby authorized and empowered, to make such further applications, motions or proceedings to or before such other courts and judicial regulatory and administrative bodies, and take such other steps, in Canada, the United States of America or elsewhere, as may be necessary or advisable to give effect to this Claims

Process Order and any other Order granted by this Court.

THE FOLLOWING PARTIES APPROVE THE FORM OF THIS ORDER AND CONSENT TO EACH OF THE ORDERS, IF ANY, THAT ARE INDICATED ABOVE AS BEING BY CONSENT:

Lawyers for the Petitioners

DLA Piper (Canada) LLP
(Mary I.A. Buttery and H. Lance Williams)

and

Osler, Hoskin & Harcourt LLP
(Marc Wasserman and Patrick Riesterer)

BY THE COURT

REGISTRAR

Schedule "A"

Counsel List	
Name	**Party Represented**
Kathryn Esaw Angela Crimeni	Canadian Counsel for Morgan Stanley Senior Funding, Inc., as Administrative Agent and Collateral Agent under the First Lien Credit Facility
John Sandrelli Tevia Jeffries	UMWA 1974 Pension Plan and Trust
Heather L. Jones	Kevin James
Aaron Welch	Her Majesty the Queen in right of British Columbia
Craig Bavis Stephanie Drake	USW, Local 1-424
Kieran Siddall	Pine Valley Mining Corporation
David Wachowich Leanne Krawchuck (by phone)	Conuma Coal Resources Limited

Schedule "B"
Definitions

"**Allowed Claim**" means the amount, status and/or validity of the Claim of a Claimant finally determined in accordance with the Claims Process, which shall be final and binding for voting and/or distribution purposes under the Plan or otherwise. A Claim will be "finally determined" and become an Allowed Claim in accordance with the Claims Process if:

i. An Employee Claimant was sent an Employee Claim Amount Notice by the Monitor and the Employee Claimant does not file a Notice of Dispute of Employee Claim by the Claims Bar Date;

ii. A Claimant filed a Proof of Claim by the Claims Bar Date or the Restructuring Claims Bar Date, as applicable, and the Monitor has not sent a Notice of Revision or Disallowance by the deadline set out in paragraph **35** of the Claims Process Order;

iii. The Monitor has sent the Claimant a Notice of Revision or Disallowance in accordance with the Claims Process and the Claimant has not sent a Notice of Dispute in response by the deadline set out in paragraph **36** of the Claims Process Order;

iv. The Claimant sent a Notice of Dispute by the deadline set out in paragraph **36** and the Monitor and the Claimant have consensually resolved the disputed Claim; or

v. The Court has made a determination with respect to the Claim and no appeal or application for appeal therefrom has been taken or served on either party, or if any appeal(s) or applications for leave to appeal or further appeal have been taken therefrom or served on either party, any (and all) such appeal(s) or application(s) have been dismissed, determined or withdrawn;

"**Business Day**" means any day, other than a Saturday, Sunday or holiday, on which banks in Vancouver, British Columbia are generally open for business;

"**CCAA**" means the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended;

"**CCAA Charge**" means any of the charges granted by the Court in the CCAA Proceedings pursuant to the Initial Order, the SISP Order and any further Orders of the Court;

"**CCAA Proceedings**" means the CCAA proceedings commenced by the Walter Canada Group, being Supreme Court of British Columbia Action No. S-1510120, on the Commencement Date pursuant to the Initial Order;

"**Claim**" means (i) any Pre-Commencement Claim, (ii) any Restructuring Claim; (iii) any Employee Claim (iv) any Intercompany Claim, (v) any Directors/Officers Claim, or (vi) the UMWA 1974 Pension Plan Claims;

"**Claims Bar Date**" means October 5, 2016 at 5:00 p.m. (Vancouver Time) or such other date as may be ordered by the Court;

"**Claims Package**" means the document package which includes a copy of (i) this Claims Process Order; (ii) the Instruction Letter, (iii) a blank Proof of Claim, and (v) such other materials as the Monitor, in consultation with the Walter Canada Group, considers necessary or appropriate;

"**Claims Process**" means the call for claims to be administered by the Monitor, in consultation with the Walter Canada Group, pursuant to the terms of this Claims Process Order;

"**Claims Process Order**" means this Order establishing a claims process;

"**Commencement Date**" means December 7, 2015;

"**Court**" means the Supreme Court of British Columbia;

"**Claimant**" means any Person asserting a Claim, whether such Person is located in Canada, the United States or elsewhere, and includes, without limitation, the transferee or assignee of a transferred Claim that is recognised in accordance with paragraph **41** hereof, or a trustee, liquidator, receiver, manager or other Person acting on behalf of such Person;

"**CRO**" has the meaning attributed to it in paragraph **11** of the Claims Process Order;

"**Director**" means any Person who is or was, or may be deemed to be or have been, whether by statute, operation of law or otherwise, a director of any one or more members of the Walter Canada Group;

"**Directors/Officers Claim**" means any right or claim of any Person against one or more of the Directors and/or Officers that relates to a Pre-Commencement Claim or a Restructuring Claim, however arising, for which the Directors and/or Officers are by statute or otherwise by law liable to pay in their capacity as Directors and/or Officers;

"**Dispute Package**" means, with respect to any Claim, a copy of the related Proof of Claim, Notice of Revision or Disallowance and Notice of Dispute;

"**Employees**" means all employees of the Walter Canada Group as at the Commencement Date (including inactive employee of a Walter Canada Group entity as of the Commencement Date and including any employees of the Wolverine mine who were terminated after the Commencement Date due to the expiration of any recall or other rights under the applicable collective bargaining agreement), and "Employee" means any one of them. For the avoidance of doubt, Employee does not include individuals whose employment was terminated for any reason, without regard to any period of notice, prior to the Commencement Date;

"**Employee Claim**" means a Claim held by an Employee against a Walter Canada Group entity in respect of Wages and Benefits and, for greater certainty, does not include any other Claim of an Employee;

"**Employee Claimant**" means an Employee with an Employee Claim;

"**Employee Claim Amount Notice**" means a form of notice in which the Monitor may include in an Employee's Claims Package setting out the Monitor's determination of such Claimant Employee's Claim, which shall be in substantially the form set out in **Schedule "D"**;

"**Financial Advisor**" means PJT Partners LP as financial advisor to the Walter Canada Group;

"**Initial Order**" means the Order of this Honourable Court granted on December 7, 2015 in these CCAA Proceedings, as amended;

"**Instruction Letter**" means the letter regarding completion of a Proof of Claim, which letter shall be substantially in the form attached hereto as **Schedule "C"**;

"**Intercompany Claim**" means: (i) any Claim of a member of the Walter Canada Group against another member of the Walter Canada Group (including for greater certainty any amount secured by one of the CCAA Charges) and (ii) any Claim by Walter Energy, Inc. or any of its non-Canadian affiliates against the Walter Canada Group in respect of the Hybrid Debt Structure (as defined in the First Affidavit of William E. Harvey sworn December 5, 2015 in these proceedings), but excluding any other Claims of Walter Energy, Inc. or any of its non-Canadian affiliates against the Walter Canada Group and any Claims that Warrior Met Coal, LLC acquired from Walter Energy, Inc. or any of its U.S. affiliates against the Walter Canada Group;

"**Lien**" means any valid and enforceable mortgage, charge, pledge, assignment by way of security, lien, hypothec, security interest, deemed trust or other encumbrance granted or arising pursuant to a written agreement or statute or otherwise created by law;

"**Meeting Date**" means the date set for the meeting of the Walter Canada Group's Claimants, to be set by further Order of the Court;

"**Monitor**" means KPMG Inc., in its capacity as Court-appointed Monitor pursuant to the Initial Order;

"**Monitor's Website**" means the Monitor's website located at http://www.kpmg.com/ca/walterenergycanada;

"**Newspaper Notice**" means the notice of Claims Process to be published in the newspapers listed in paragraph **17** of this Claims Process Order, calling for any and all Claims of Claimants against the Walter Canada Group in substantially the form attached hereto as **Schedule "I"**;

"**Notice of Disclaimer or Resiliation**" means a written notice in any form issued on or after the Commencement Date by a member of the Walter Canada Group, with the prior consent of the Monitor, advising a Person of the restructuring, disclaimer, resiliation, termination or breach of any contract, employment agreement, lease or other agreement or arrangement of any nature whatsoever, whether written or oral, and whether such restructuring, disclaimer, resiliation, termination or breach took place or takes place before or after the date of this Claims Process Order;

"**Notice of Dispute**" means the notice that may be delivered by a Claimant who has received a Notice of Revision or Disallowance disputing such Notice of Revision or Disallowance, which notice shall be in substantially the form attached hereto as **Schedule "H"**;

"**Notice of Dispute of Employee Claim**" means the notice that may be delivered by an Employee Claimant who has received an Employee Claim Amount Notice and disputes the amount of the Employee Claim set out therein, which notice shall be in substantially the form attached hereto as **Schedule "E"**;

"**Notice of Revision or Disallowance**" means the notice that may be delivered by the Monitor to a Claimant advising that the Monitor has revised or disallowed in whole or in part such Claimant's Claim as set out in its Proof of Claim, which notice shall be substantially in the form attached hereto as **Schedule "G"**;

"**Officer**" means any Person who was, or may be deemed to be or have been, whether by statute, operation of law or otherwise, an officer of any one or more members of the Walter Canada Group;

"**Person**" means any individual, firm, partnership, joint venture, venture capital fund, association, trust, trustee, executor, administrator, legal personal representative, estate, group, body corporate (including a limited liability company and an unlimited liability company), corporation, unincorporated association or organisation, governmental authority, syndicate or other entity, whether or not having legal status;

"**Plan**" means any plan of compromise or arrangement of the Walter Canada Group pursuant to the CCAA, or any scheme of distribution by a trustee in bankruptcy of the Walter Canada Group under the *Bankruptcy and Insolvency Act*.

"**Pre-Commencement Claim**" means any right or claim of any Person that may be asserted or made in whole or in part against the Walter Canada Group (or any of them), whether or not asserted or made, in connection with any indebtedness, liability or obligation of any kind whatsoever and any interest accrued thereon or costs payable in respect thereof, in existence on, or which is based on, an agreement, event, fact, act or omission or other matter which occurred, was entered into or relates in whole or in part prior to the Commencement Date, at law or in equity by reason of the commission of a tort (intentional or unintentional), any breach of contract or other agreement (oral or written), any breach of duty (including without limitation, any legal, statutory, equitable or fiduciary duty), any right of ownership or title to property or assets, any other claim on property or assets (including a royalty right or intellectual property right), or right to a trust or deemed trust (statutory, express, implied, resulting, constructive or otherwise) or for any reason whatsoever against any members of the Walter Canada Group or any of their property or assets, any whether or not any indebtedness, liability or obligation is reduced to judgment, liquidated, un-liquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present, future, known or unknown, by guarantee, surety or otherwise and whether or not any right or claim is executive or anticipatory in nature including any right or ability of any Person to advance a claim for contribution or indemnity or otherwise with respect to any matter, action, cause or chose in action whether existing at present or commenced in the future, together with any other rights or claims not referred to above that are or would be claims provable in bankruptcy had the Walter Canada Group (or any of them) become bankrupt on the Commencement Date and, for greater certainty, includes any Tax Claim; provided, however, that "Pre-Commencement Claim" shall not include an Employee Claim or an Unaffected Claim;

"**Proof of Claim**" means the form to be completed and filed by a Claimant setting forth its proposed Claim, which shall be substantially in the form attached hereto as **Schedule "E"**;

"**Restructuring Claim**" means any right or claim of any Person against the Walter Canada Group (or any of them) in connection with any indebtedness, liability or obligation of any kind whatsoever owed by the Walter Canada Group (or any of them) to such Person arising out of the restructuring, disclaimer, resiliation, termination or breach on or after the Commencement Date of any contract, employment agreement, lease or other agreement or arrangement, whether written or oral, and whether such restructuring, disclaimer, resiliation, termination or breach took place or takes place before or after the date of this Claims Process Order; provided, however, that "Restructuring Claim" shall not include an Employee Claim, an UMWA 1974 Pension Plan Claim or an Unaffected Claim;

"**Restructuring Claims Bar Date**" means the later of (i) the Claims Bar Date; and (ii) 5:00 p.m. (Vancouver Time) on the day that is twenty (20) Business Days after the date of the applicable Notice of Disclaimer or Resiliation or such other date as may be ordered by the Court;

"**SISP Order**" means the Order of this Honourable Court granted on January 5, 2016 in these CCAA Proceedings approving, among other things, a sale and investment solicitation process with respect to the Walter Canada Group's assets.

"**Tax**" or "**Taxes**" means any and all taxes, duties, fees, premiums, assessments, imposts, levies and other charges of any kind whatsoever, including all interest, penalties, fines, additions to tax or other additional amounts in respect thereof, and including those levied on, or measured by, or referred to as, income, gross receipts, profits, capital, transfer, land transfer, sales, goods and services, harmonized sales, use, value-added, excise, stamp, withholding, business, franchising, property, development, occupancy, employer health, payroll, employment, health, social services, education and social security taxes, all surtaxes, all customs duties and import and export taxes, countervail and anti-dumping, all licence, franchise and registration fees and all employment insurance, health insurance and Canada, Quebec and other government pension plan premiums or contributions.

"**Tax Claim**" means any Claim against the Walter Canada Group (or any of them) for any Taxes in respect of any taxation year or period ending on or prior to the Commencement Date, and in any case where a taxation year or period commences on or prior to the Commencement Date, for any Taxes in respect of or attributable to the portion of that taxation period commencing prior to the Commencement Date and up to and including the Commencement Date. For greater certainty, a Tax Claim shall include, without limitation, any and all Claims of any Taxing Authority in respect of transfer pricing adjustments and any Canadian or non-resident Tax related thereto;

"**Taxing Authorities**" means Her Majesty the Queen, Her Majesty the Queen in right of Canada, Her Majesty the Queen in right of any province or territory of Canada, the Canada Revenue Agency, any similar revenue or taxing authority of each and every province or territory of Canada and any political subdivision thereof, the Internal Revenue Service and any similar revenue or taxing authority of the federal or state governments of the United States of America and any Canadian or foreign governmental authority and "Taxing Authority" means any one of the Taxing Authorities;

"**UMWA 1974 Pension Plan Claim**" means any claim alleged by or on behalf of the United Mine Workers of America 1974 Pension Plan and Trust against any member of the Walter Canada Group;

"**United Steelworkers**" means the United Steelworkers, Local 1-424;

"**Unaffected Claim**" means, subject to further Order of this Court,

i. Any right or claim of any Person that may be asserted or made in whole or in part against the Walter Canada Group (or any of them) in connection with any indebtedness, liability or obligation of any kind which arose in respect of obligations first incurred on or after the Commencement Date (other than Restructuring Claims and Directors/Officers Claims) and any interest thereon, including any obligation of the Walter Canada Group toward Claimants who have supplied or shall supply services, utilities, goods or materials or who have or shall have advanced funds to the Walter Canada Group on or after the Commencement Date, but only to the extent of their claims in respect of the supply of such services, utilities, goods, materials or funds on or after the Commencement Date;

ii. Any claim of any bank in respect of the Cash Management System as described in the Initial Order;

iii. Any claim secured by any CCAA Charge;

iv. Any Intercompany Claim;

v. That portion of the Claim arising from a cause of action for which the Walter Canada Group entities are covered by insurance, but only to the extent of such coverage;

vi. Any claim referred to in sections 6(3), 6(5) and 6(6) of the CCAA;

vii. Any claims with respect to reasonable fees and disbursements of the CRO, the Financial Advisor, counsel of the Walter Canada Group and the Monitor or any Assistant (as defined in paragraph 4 of the Initial Order);

"**Wages and Benefits**" means all outstanding wages, salaries, benefits (including, but not limited to, medical, dental, disability, life insurance, post-retirement and pension benefits and any other similar benefits, plans or arrangements, employee assistance programs, and any contributions in respect of such benefits, plans, arrangements or programs) vacation pay, holiday pay, overtime pay, expense reimbursements, commissions, bonuses and other incentive compensation, payments under employment agreements or arrangements, collective bargaining agreements, stock options, profit sharing or other equity compensation, pay in lieu of notice, severance pay and termination pay, any amounts payable under the *Employment Standards Act*, any monies payable under the *Labour Relations Code* or due to order of the Labour Relations Board, in all cases whether owing under common law, contract, statute or otherwise.

Schedule "C"

FORM OF INSTRUCTION LETTER

INSTRUCTION LETTER FOR THE CLAIMS PROCESS FOR THE CLAIMANTS OF WALTER ENERGY CANADA HOLDINGS, INC. AND THE PETITIONERS AND PARTNERSHIPS LISTED ON SCHEDULE "A" AND SCHEDULE "C", RESPECTIVELY, OF THE INITIAL ORDER (collectively, the "Walter Canada Group")

1. Claims Procedure

By order of the Supreme Court of British Columbia (the "**Court**") dated ●, 2016 (as may be amended, restated or supplemented from time to time, (the "**Claims Process Order**"), in the proceeding commenced by Walter Energy Canada Holdings, Inc. and the other Petitioners listed on Schedule "A" to the Initial Order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, as amended (the "**CCAA**"), KPMG Inc., in its capacity as the Court-appointed Monitor of the Walter Canada Group (the "**Monitor**"), has been authorised to conduct a claims process with respect to claims against the Walter Canada Group entities (the "**Claims Process**"). A copy of the Claims Process, with all schedules, may be found on the Monitor's Website at: http://www.kpmg.com/ca/walterenergycanada. Capitalised terms used in this letter which are not defined in this letter shall have the meaning ascribed to them in the Claims Process Order.

This letter provides instructions for completing the Proof of Claim. A blank Proof of Claim is included with this letter.

The Claims Process is intended for any Person asserting a Claim (other than an Unaffected Claim) of any kind or nature whatsoever against any of the Walter Canada Group entities and/or any of their Directors and/or Officers arising before the Commencement Date, and/or any Restructuring Claim arising on or after the Commencement Date as a result of a restructuring, disclaimer, resiliation, termination or breach by any of the Walter Canada Group entities on or after the Commencement Date of any contract, employment agreement, lease or other agreement or arrangement of any nature whatsoever, whether written or oral, and whether such restructuring, disclaimer, resiliation, termination or breach took place or takes place before or after the date of Claims Process Order.

Current employees are **not** required to submit a Proof of Claim in respect of any Employee Claim pertaining to wages, including vacation pay and banked time due to them.

In the event that you are an Employee Claimant, a notice setting out the amount which the Monitor has determined to be the amount of your Employee Claim (an "**Employee Claim Amount Notice**") is enclosed with this letter, and if you do **not** dispute the nature or amount of such Employee Claim as set out in the Employee Claim Amount Notice, you are **not** required to file a Proof of Claim, a Notice of Dispute of Employee Claim or any other materials with the Monitor unless you are requested to do so. If an Employee Claim Amount Notice is enclosed and you dispute the nature or amount of your Employee Claim as set out in the Employee Claim Amount Notice, you must file a Notice of Dispute of Employee Claim (as referenced in paragraph 2 below) to avoid the barring and extinguishment of that portion of your Employee Claim that exceeds the amount set out in the Employee Claim Amount Notice. Any Employee Claimant who receives an Employee Claim Amount Notice and who does not file a Notice of Dispute of Employee Claim by the Claims Bar Date in accordance with paragraph 2 below is deemed to have accepted the nature and amount of such Employee Claim as set out in the applicable Employee Claim Amount Notice.

If an Employee Claim Amount Notice is not enclosed with this letter and you wish to file a Claim, you must file a Proof of Claim (as referenced in paragraph 2 below) to avoid the barring and extinguishment of any Claim which you may have against any of the Walter Canada Group entities and/or any of their Directors and/or Officers.

If you have any questions regarding the Claims Process, please contact the Court-appointed Monitor at the address below.

All enquiries with respect of the Claims Process should be addressed to:

KPMG Inc.
Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.*
777 Dunsmuir St
Vancouver, BC V7Y 1K4

Attention: Mark Kemp-Gee/Mike Clark
Email: mkempgee@kpmg.ca, maclark@kpmg.ca
Phone: 604-691-3397; 604-691-3468

2. **For Claimants Submitting a Proof of Claim or Notice of Dispute of Employee Claim**

If you have not received an Employee Claim Amount Notice you are required to file a Proof of Claim, in the form enclosed herewith, and **ensure that it is received by the Monitor by 5:00 p.m. (Vancouver Time) on October 5, 2016** (the "**Claims Bar Date**") to avoid the barring and extinguishment of any Claim (other than a Restructuring Claim) that you may have against any of the Walter Canada Group entities and/or any of their Directors and/or Officers.

To avoid the barring and extinguishment of any Restructuring Claim you may have against any of the Walter Canada Group entities and/or any of their Directors and/or Officers, you are required to file a Proof of Claim, in the form enclosed herewith, and ensure **that it is received by the Monitor by the later of: (a) the Claims Bar Date; and (b) 5:00 p.m. (Vancouver Time) on the day which is twenty (20) Business Days after the date of the Notice of Disclaimer or Resiliation** sent to you (the "**Restructuring Claims Bar Date**").

If you have received an Employee Claim Amount Notice and you dispute the nature or amount of the Employee Claim as set out in such Employee Claim Amount Notice, you are required to file a Notice of Dispute of Employee Claim, in the form enclosed herewith, and ensure that it is received by the Monitor by the Claims Bar Date or such further date as stipulated by the Monitor.

For the avoidance of doubt, any Claim or Restructuring Claim you may have against the Walter Canada Group must be filed in accordance with the procedures set forth herein. Proofs of Claim filed solely with the United States Bankruptcy Court, Northern District of Alabama in Walter Energy, Inc.'s Chapter 11 proceedings, are invalid, and failure to file an additional Proof of Claim with the Monitor pursuant to these procedures will lead to the consequences detailed below. Please note, however, that if you received an Employee Claim Amount Notice with this letter and you fail to file an additional Proof of Claim with the Monitor pursuant to these procedures, your Employee Claim shall be deemed to be the amount set forth in the Employee Claim Amount Notice.

Additional Proof of Claim forms can be found on the Monitor's website at http://www.kpmg.com/ca/walterenergycanada or obtained by contacting the Monitor at the address indicated above and providing particulars as to your name, address, facsimile number and email address. Once the Monitor has this information, you will receive, as soon as practicable, additional Proof of Claim forms.

If you are submitting your Proof of Claim electronically, please submit it in PDF form and ensure that the name of the file is **[legal name of Claimant]**poc.pdf. If you submit your claim electronically and you do **not** receive an email confirming receipt of your Proof of Claim within one (1) business day of submitting the Proof of Claim, your Proof of Claim has **not** been successfully received by the Monitor and you should submit your Proof of Claim using an alternate method.

UNLESS YOU ARE THE HOLDER OF AN EMPLOYEE CLAIM FOR WHICH YOU HAVE RECEIVED AN EMPLOYEE CLAIM AMOUNT NOTICE THAT YOU DO NOT DISPUTE, **IF A PROOF OF CLAIM IN**

RESPECT OF YOUR CLAIM IS NOT RECEIVED BY THE MONITOR BY THE CLAIMS BAR DATE OR THE RESTRUCTURING CLAIMS BAR DATE, AS APPLICABLE:

A. YOUR CLAIM SHALL BE FOREVER BARRED AND EXTINGUISHED AND YOU WILL BE PROHIBITED FROM MAKING OR ENFORCING ANY CLAIM AGAINST ANY MEMBER OF THE WALTER CANADA GROUP AND/OR ANY OF THEIR DIRECTORS AND/OR OFFICERS;

B. YOU SHALL NOT BE PERMITTED TO VOTE ON THE PLAN OR ENTITLED TO ANY FURTHER NOTICE OR DISTRIBUTION UNDER THE PLAN, IF ANY;

C. YOU SHALL NOT BE ENTITLED TO ANY PROCEEDS OF SALE OF ANY MEMBER OF THE WALTER CANADA GROUP'S ASSETS; AND,

D. YOU SHALL NOT BE ENTITLED TO PARTICIPATE AS A CLAIMANT IN THE CCAA PROCEEDINGS OF ANY MEMBER OF THE WALTER CANADA GROUP.

Schedule "D"

FORM OF EMPLOYEE CLAIM AMOUNT NOTICE

EMPLOYEE CLAIM AMOUNT NOTICE
OF WALTER ENERGY CANADA HOLDINGS, INC. AND THE PETITIONERS AND PARTNERSHIPS LISTED ON SCHEDULE "A" AND SCHEDULE "C", RESPECTIVELY, OF THE INITIAL ORDER
(collectively, the "Walter Canada Group")

Full Legal Name of Claimant: ______________________________.

Pursuant to the order of the Supreme Court of British Columbia dated ●, 2016, and as may be amended restated or supplemented from time to time (the "**Claims Process Order**"), KPMG Inc., in its capacity as the Court-appointed Monitor of the Walter Canada Group, hereby gives you notice that the Walter Canada Group, in consultation with the Monitor, have determined your Employee Claim to be as follows:

	Walter Entity	**Unsecured** **($CDN)**
Contractual Severance Pay (per **[collective bargaining / employment]** agreement)		
Group Termination Pay		
Northern Working Allowance		
Section 54 Claim		
Section 54 Claim Mitigation		
Other (specify): ____________________		
Total Claim		

If you do not agree with this Employee Claim Amount Notice, please take note of the following:

If you intend to dispute this Employee Claim Amount Notice, you must deliver a Notice of Dispute of Employee Claim, in the form attached hereto, by prepaid registered mail, personal delivery, email (in PDF format), or courier to the following address:

KPMG Inc.
Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.*
777 Dunsmuir St
Vancouver, BC V7Y 1K4

Attention: Mark Kemp-Gee/Mike Clark
Email: mkempgee@kpmg.ca, maclark@kpmg.ca
Phone: 604-691-3397; 604-691-3468

so that such Notice of Dispute of Employee Claim is received by the Monitor by 5:00 p.m. (Vancouver time) on October 5, 2016, being the Claims Bar Date, or such other date as may be agreed by the Monitor. The form of Notice of Dispute of Employee Claim is attached to this Notice.

If you do not deliver a Notice of Dispute of Employee Claim by the time specified, the nature and amount of your Employee Claim, shall be as set out in this Employee Claim Amount Notice for voting and/or distribution purposes.

IF YOU FAIL TO TAKE ACTION WITHIN THE PRESCRIBED TIME PERIOD, THIS EMPLOYEE CLAIM AMOUNT NOTICE WILL BE BINDING UPON YOU.

DATED at ____________________, ____________________, ____________________, this __________
day of ________________________, 2016

KPMG INC.

In its capacity as Court-appointed Monitor
of Walter Energy Canada Holdings, Inc., *et al.* and not in its personal
or corporate capacity

Per: ______________________________

Name: ______________________________

Title: ______________________________

Schedule “E”

FORM OF PROOF OF CLAIM

PROOF OF CLAIM AGAINST WALTER ENERGY CANADA HOLDINGS, INC. AND THE PETITIONERS AND PARTNERSHIPS LISTED ON SCHEDULE “A” AND SCHEDULE “C”, RESPECTIVELY, OF THE INITIAL ORDER (collectively, the “Walter Canada Group”)

Please read the enclosed Instruction Letter carefully prior to completing this Proof of Claim. Defined terms not defined within this Proof of Claim form shall have the meaning ascribed thereto in the Claims Process Order dated ●, 2016, as may be amended, restated or supplemented from time to time.

1. **Particulars of Claimant**

a. Please complete the following (Full legal name should be the name of the original Claimant, regardless of whether an assignment of a Claim, or a portion thereof, has occurred prior to or following the Commencement Date) and Full Mailing Address of the Claimant (the Original Claimant, not the Assignee.)

Full Legal Name:	
Full Mailing Address:	
Telephone Number:	
Facsimile Number:	
Email Address:	
Attention (Contact Person):	

b. Has the Claim been sold, transferred or assigned by the Claimant to another party (an Assignee")

Yes: [______]

No: [______]

2. **Particulars of Assignee (if any)**

a. Please complete the following if all or a portion of the Claim has been assigned, insert full legal name of assignee(s) of the Claim. If there is more than one assignee, please attach a separate sheet with the required information:

Full Legal Name of Assignee:	
Full Mailing Address of Assignee:	
Telephone Number of Assignee:	
Facsimile Number of Assignee:	

Email Address of Assignee:	
Attention (Contact Person):	

Proof of Claim

I, ________________________ ,(*name of individual Claimant or Representative of corporate Claimant*), of ________________________(*City, Province or State*) do hereby certify: that I [__] am a Claimant; OR

that I [______] am a Claimant; OR

[______] am ________________________ (*state position or title*) of ______ ________________________(*name of corporate Claimant*) which is a Claimant;

that I have knowledge of all the circumstances connected with the Claim referred to below;

that ________________________(*name of applicable Walter Canada Group entity and/or Directors and/or Officers*) was and still is indebted to the Claimant as follows;

CLAIM (other than a Restructuring Claim):

$ ________________________ (*insert value of Claim*)

RESTRUCTURING CLAIM

$ ________________________ (*insert value of Claim arising after the Commencement Date resulting from the restructuring, disclaimer, resiliation, termination or breach after the Commencement Date of any contract, employment agreement, lease or other agreement or arrangement of any nature whatsoever, whether written or oral)*;

that the Claimant's Claim and the Claimant's invoices, statements and/or supporting documents attached are denominated in:

[ ] Canadian Dollars

[ ] U.S. Dollars

[ ] Other ____________ (*stipulate other currency referenced*)

A. TOTAL CLAIM(S): $ ________________

Nature of Claim:

(*Check and complete appropriate category*)

[______] A. UNSECURED CLAIM OF$ ________________. That in respect of this debt, no assets of any of the Walter Canada Group entities are pledged as security.

[______] B. SECURED CLAIM OF$ ________________. That in respect of this debt, assets of ________________________ (*insert name of applicable Walter*

Canada Group entity) valued at $ ______________________________ are pledged to me as security, particulars of which are as follows.

(*Give full particulars of the security, including the date on which the security was given and the value at which you assess the security, and attach a copy of the security documents.*)

Particulars of Claims:

Other than as already set out herein, the particulars of the undersigned's total Claim and/or Restructuring Claim are attached.

(Provide all particulars of the claims and supporting documentation, including amount, description of transaction(s) or agreement(s) giving rise to the claims, name of any guarantor which has guaranteed the claims, and amount of invoices, particulars of all credits, discounts, etc. claimed, description of the security, if any, granted by the Walter Canada Group entities to the Claimant and estimated value of such security. Where a claim is advanced against any Directors or Officers, please provide either a reference to a statutory authority for your claim or enclose a draft Notice of Civil Claim.)

Filing of Claims:

This Proof of Claim **must be received by the Monitor by no later than 5:00 p.m. (Vancouver Time) on October 5, 2016** (the "**Claims Bar Date**") unless your claim is a Restructuring Claim.

Proofs of Claim for Restructuring Claims arising after the Commencement Date resulting from a restructuring, disclaimer, resiliation, termination or breach after the Commencement Date of any contract, employment agreement, lease or other agreement, or arrangement of any nature whatsoever, whether written or oral, **must be received by the Monitor by the later of (a) the Claims Bar Date, and (b) by 5:00 p.m. (Vancouver Time) on the day which is twenty (20) Business Days after the date of the applicable Notice of Disclaimer or Resiliation** (the "**Restructuring Claims Bar Date**")

Failure to file your proof of claim as directed by the Claims Bar Date or Restructuring Claims Bar Date, as applicable, will result in your claim being forever barred and extinguished and you will be prohibited from making or enforcing a claim against any of the Walter Canada Group entities and/or any of their Directors and/or Officers.

KPMG Inc.
Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.*
777 Dunsmuir St
Vancouver, BC V7Y 1K4

Attention: Mark Kemp-Gee/Mike Clark
Email: mkempgee@kpmg.ca, maclark@kpmg.ca
Phone: 604-691-3397; 604-691-3468

DATED this __________ day of ____________________, 2016.

______________________________ Per: ______________________________

Witness: Print name of Claimant:

If Claimant is not an individual, print name and title of authorised signatory.

Name: ____________________

Title: ____________________

Schedule "F"

FORM OF NOTICE OF DISPUTE OF EMPLOYEE CLAIM

NOTICE OF DISPUTE
OF WALTER ENERGY CANADA HOLDINGS, INC. AND THE PETITIONERS AND PARTNERSHIPS LISTED ON SCHEDULE "A" AND SCHEDULE "C", RESPECTIVELY, OF THE INITIAL ORDER
(collectively, the "Walter Canada Group")

Pursuant to the order of the Supreme Court of British Columbia dated ●, 2016, and as may be amended restated or supplemented from time to time (the "**Claims Process Order**"), I/we hereby give you notice of my/our intention to dispute the Notice of Employee Claim Amount bearing Reference Number __________ _______ and dated _________________ , 2016 issued by KPMG Inc., in its capacity as Monitor of the Walter Canada Group in respect of my/our Claim.

Full Legal Name of Claimant: ____

	Employee Claim Amount per Notice of Employee Claim Amount **($CDN)**	**Employee Claim Amount Asserted** **($CDN)**
Contractual Severance Pay (per **[collective bargaining / employment]** agreement)		
Group Termination Pay		
Northern Working Allowance		
Section 54 Claim		
Section 54 Claim Mitigation		
Other (specify): ________________________		
TOTAL CLAIM		

Reasons for Dispute (attach additional sheet and copies of supporting documentation if necessary):

____

____

____

____

____

____

Signature of Individual: ________________________________

Date: ________________________________

(Print name): ________________________________

Telephone number: ________________________________

Facsimile number: ________________________________

Email address: ________________________________

Mailing Address: ________________________________

____

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This form and supporting documentation is to be returned by prepaid registered mail, personal delivery, email (in PDF format), or courier to the address indicated herein and is to be received by the Monitor by 5:00 p.m. (Vancouver time) on October 5, 2016 (the Claims Bar Date) or such other date as may be agreed to by the Monitor. If this Notice of Dispute is not received by the Monitor on or before the Claims Bar Date, your Employee Claim will be the amount set out in your Notice of Employee Claim Amount.

Where this Notice of Dispute of Employee Claim is being submitted electronically, please submit one PDF file with the file name as follows: **[legal name of Claimant]**pocdispute.pdf. If you submit your Notice of Dispute electronically and you do **not** receive an email confirming receipt of your Notice of Dispute within one (1) business day of submitting the Notice of Dispute of Employee Claim, your Notice of Dispute of Employee Claim has **not** been successfully received by the Monitor and you should submit your Notice of Dispute of Employee Claim using an alternative method.

Address for service of Notices of Dispute of Employee Claim:

KPMG Inc.
Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.*
777 Dunsmuir St
Vancouver, BC V7Y 1K4

Attention: Mark Kemp-Gee/Mike Clark
Email: mkempgee@kpmg.ca, maclark@kpmg.ca
Phone: 604-691-3397; 604-691-3468

Schedule "G"

FORM OF NOTICE OF REVISION OR DISALLOWANCE

NOTICE OF REVISION OR DISALLOWANCE OF WALTER ENERGY CANADA HOLDINGS, INC. AND THE PETITIONERS AND PARTNERSHIPS LISTED ON SCHEDULE "A" AND SCHEDULE "C", RESPECTIVELY, OF THE INITIAL ORDER (collectively, the "Walter Canada Group")

Full Legal Name of Claimant: ______________________________

Reference Number: ______________________________

Pursuant to the order of the Supreme Court of British Columbia dated ●, 2016, and as may be amended restated or supplemented from time to time (the "**Claims Process Order**"), KPMG Inc., in its capacity as Monitor of the Walter Canada Group, hereby gives you notice that the Walter Canada Group, in consultation with the Monitor, have reviewed your Proof of Claim and have revised or disallowed your Claim as follows:

	Proof of Claim as Submitted **($CDN)**	**Revised Claim as accepted** **($CDN)**	**Secured** **($CDN)**	**Unsecured** **($CDN)**
Total Claim				

Reason for the Revision or Disallowance

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If you do not agree with this Notice of Revision or Disallowance, please take note of the following:

If you intend to dispute a Notice of Revision or Disallowance, you must deliver a Notice of Dispute, in the form attached hereto, by prepaid registered mail, personal delivery, email (in PDF format), or courier to the address indicated herein so that such Notice of Dispute is received by the Monitor by the later of November 7, 2016 and the day that is twenty (20) Business Days after the date of this Notice of Revision or Disallowance, or such other date as may be agreed by the Monitor. The form of Notice of Dispute is attached to this Notice.

Where a Notice of Dispute is being submitted electronically, please submit one PDF file with the file named as follows: ***[legal name of Claimant]****pocdispute.pdf.*

If you do not deliver a Notice of Dispute by the time specified, the nature and amount of your Claim, if any, shall be as set out in this Notice of Revision or Disallowance for voting and/or distribution purposes.

Address for service of Notices of Dispute:

KPMG Inc.
Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.*
777 Dunsmuir St
Vancouver, BC V7Y 1K4

Attention: Mark Kemp-Gee/Mike Clark
Email: mkempgee@kpmg.ca, maclark@kpmg.ca
Phone: 604-691-3397; 604-691-3468

IF YOU FAIL TO TAKE ACTION WITHIN THE PRESCRIBED TIME PERIOD, THIS NOTICE OF REVISION OR DISALLOWANCE WILL BE BINDING UPON YOU.

DATED at ______________________, ________________, ________________, this ________ day of ____________________________, 2016

KPMG INC.

In its capacity as Court-appointed Monitor
of Walter Energy Canada Holdings, Inc. *et al.* and not in its personal or
corporate capacity

Per: ______________________________

Name: ______________________________

Title: ______________________________

Schedule "H"

FORM OF NOTICE OF DISPUTE

NOTICE OF DISPUTE OF WALTER ENERGY CANADA HOLDINGS, INC. AND THE PETITIONERS AND PARTNERSHIPS LISTED ON SCHEDULE "A" AND SCHEDULE "C", RESPECTIVELY, OF THE INITIAL ORDER (collectively, the "Walter Canada Group")

Pursuant to the order of the Supreme Court of British Columbia dated ●, 2016, and as may be amended restated or supplemented from time to time (the "**Claims Process Order**"), I/we hereby give you notice of my/our intention to dispute the Notice of Revision or Disallowance bearing Reference Number ________________ and dated __________________, 2016 issued by KPMG Inc., in its capacity as Monitor of the Walter Canada Group in respect of my/our Claim.

Full Legal Name of Claimant: ______________________________________

	Proof of Claim as Submitted **($CDN)**	**Revised Claim as accepted** **($CDN)**	**Secured** **($CDN)**	**Unsecured** **($CDN)**
Total Claim				

Reasons for Dispute (attach additional sheet and copies of supporting documentation if necessary):

____

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____

Signature of Individual: ______________________________

Date: ______________________________

(Print name): ______________________________

Telephone number: ______________________________

Facsimile number: ______________________________

Email address: ______________________________

Mailing Address: ______________________________

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This form and supporting documentation is to be returned by prepaid registered mail, personal delivery, email (in PDF format), or courier to the address indicated herein and is to be received by the Monitor by the later of December 6, 2016 and the day that is twenty (20) Business Days after the date of the Notice of Revision or Disallowance or such other date as may be agreed to by the Monitor.

Where this Notice of Dispute is being submitted electronically, please submit one PDF file with the file name as follows: **[legal name of Claimant]**pocdispute.pdf. If you submit your Notice of Dispute electronically and you do **not** receive an email confirming receipt of your Notice of Dispute within one (1) business day of submitting the Notice of Dispute, your Notice of Dispute has **not** been successfully received by the Monitor and you should submit your Notice of Dispute using an alternative method.

Address for service of Notices of Dispute:

KPMG Inc.
Court-appointed Monitor of Walter Energy Canada Holdings, Inc., *et al.*
777 Dunsmuir St
Vancouver, BC V7Y 1K4

Attention: Mark Kemp-Gee/Mike Clark
Email: mkempgee@kpmg.ca, maclark@kpmg.ca
Phone: 604-691-3397; 604-691-3468

Schedule "I"

FORM OF NEWSPAPER NOTICE

NOTICE TO THE CREDITORS OF WALTER ENERGY CANADA HOLDINGS, INC. AND THE PETITIONERS AND PARTNERSHIPS LISTED ON SCHEDULE "A" AND SCHEDULE "C", RESPECTIVELY, OF THE INITIAL ORDER (collectively, the "Walter Canada Group")

RE: NOTICE OF THE CLAIMS PROCESS FOR THE WALTER CANADA GROUP PURSUANT TO THE COMPANIES' CREDITORS ARRANGEMENT ACT ("CCAA")

This notice is being published pursuant to an order of the Supreme Court of British Columbia dated ●, 2016 (the "**Claims Process Order**") which approved a claims process for the determination of certain claims against the Walter Canada Group and/or their Directors and/or Officers. Any capitalized terms used but not defined herein have the meanings ascribed to them in the Claims Process Order.

The claims procedure only applies to the Claims or Claimants described in the Claims Process Order. A copy of the Claims Process Order and other public information concerning the CCAA proceedings can be obtained on the website of KPMG Inc., the Court-Appointed Monitor of the Walter Canada Group (the "**Monitor**") at http://www.kpmg.com/ca/walterenergycanada. Any person who may have a claim against any of the Walter Canada Group entities and/or any of their Directors and/or Officers should carefully review and comply with the Claims Process Order.

Any person having a Claim against any of the Walter Canada Group entities and/or any of their Directors and/or Officers arising or relating to the period prior to December 7, 2015 (the "**Commencement Date**"), which would have been a claim provable in bankruptcy had the Walter Canada Group become bankrupt on the Commencement Date and who does not receive an Employee Claim Amount Notice with their Claims Package, or who receives an Employee Claim Amount Notice with their Claims Packages, but disputes the amount or nature of their Employee Claim as listed in their Employee Claim Amount Notice, must send a Proof of Claim to the Monitor, **to be received by the Monitor by no later than 5:00 p.m. (Vancouver Time) on October 5, 2016** (the "**Claims Bar Date**").

Proofs of Claim for claims arising as a result of a restructuring, disclaimer, resiliation, termination or breach by any of the Walter Canada Group entities on or after the Commencement Date of any contract, employment agreement, lease or other agreement or arrangement of any nature whatsoever, whether written or oral, **must be received by the Monitor by no later than (a) the Claims Bar Date, and (b) 5:00 p.m. (Vancouver Time) on which is twenty (20) Business Days after the date of the notice of disclaimer or resiliation sent by the Monitor to such Claimant.**

For the avoidance of doubt, any claim a Claimant may have against any of the Walter Canada Group entities must be filed in accordance with the procedures set forth in the Claims Process Order. Proofs of Claim filed solely with the United States Bankruptcy Court, Northern District of Alabama in respect of Walter Energy, Inc.'s Chapter 11 proceedings are invalid.

Claimants requiring more information or who have not received a Proof of Claim form or Claims Package should contact the Monitor by phone at ● or email at ● or visit the Monitor's website at http://www.kpmg.com/ca/walterenergycanada.

UNLESS EXPRESSLY PROVIDED IN THE CLAIMS PROCESS ORDER, HOLDERS OF CLAIMS THAT DO NOT FILE PROOFS OF CLAIM WITH THE MONITOR BY THE APPLICABLE DEADLINE SPECIFIED ABOVE SHALL NOT BE ENTITLED TO ANY FURTHER NOTICE OR DISTRIBUTION UNDER A PLAN, IF ANY, OR OF ANY PROCEEDS OF SALE OF ANY OF THE WALTER CANADA GROUP'S ASSETS, OR TO PARTICIPATE AS A CLAIMANT IN THE CCAA PROCEEDINGS OF THE WALTER CANADA GROUP, AND SHALL BE PROHIBITED FROM MAKING OR ENFORCING ANY CLAIM AGAINST ANY OF THE WALTER CANADA GROUP ENTITIES AND/OR ANY OF THEIR DIRECTORS AND/OR OFFICERS. ADDITIONALLY, ANY CLAIMS SUCH CLAIMANT MAY HAVE

AGAINST ANY OF THE WALTER CANADA GROUP ENTITIES AND/OR ANY OF THEIR DIRECTORS AND/OR OFFICERS SHALL BE FOREVER BARRED AND EXTINGUISHED.

Schedule "J"

WALTER CANADA CLAIMS PROCESS KEY DATES

Event	Date
Issuance of the Claims Process Order	August 15, 2016
Monitor to post on its Website a copy of the Claims Process Order, a blank Proof of Claim form, the Instruction Letter and a blank Notice of Dispute form.	August 22, 2016
Monitor to send Claims Packages to known Claimants	August 24, 2016
Deadline for UMWA Pension Plan to serve Notice of Claim	August 26, 2016
Monitor to have Newspaper Notice published for one Business Day in the Globe and Mail (National Edition), the Vancouver Sun, the Tumbler Ridge News and the Chetwynd Echo	August 29, 2016
Deadline for Petitioners and other stakeholders to serve Response to Notice of Claim of UMWA 1974 Pension Plan	September 26, 2016
Claims Bar Date	October 5, 2016
~~Filing of the Intercompany Claims Report~~	~~October 5, 2016~~
Deadline for UMWA Pension Plan to serve reply	October 5, 2016
Monitor to seek a scheduling appointment before the Court for a hearing of a motion to determine the validity of the UMWA 1974 Pension Plan Claim, if applicable	Following service by UMWA 1974 Pension Plan to prove the enforceability of its Claim
Monitor to send Notices of Revision or Disallowance in respect of Pre-Commencement Claims or Employee Claims	November 7, 2016
Claimants to send Notices of Dispute to the Monitor in respect of Pre-Commencement Claims or Employee Claims	December 6, 2016
Disputing party to bring a motion to the Court to resolve a disputed Claim in respect of Pre-Commencement Claims or Employee Claims	January 9, 2017

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*, S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT OF WALTER ENERGY CANADA HOLDINGS, INC., AND THOSE PARTIES LISTED ON SCHEDULE "A"

PETITIONERS

ORDER MADE AFTER APPLICATION
(CLAIM PROCESS ORDER)

DLA PIPER (CANADA) LLP
Barristers & Solicitors
2800 Park Place
666 Burrard Street
Vancouver, BC V6C 2Z7

Tel. No. 604.687.9444
Fax No. 604.687.1612

Client Matter No. 15375-00001 TAG/mlf

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TAB 119

SUPREME COURT
OF BRITISH COLUMBIA
VANCOUVER REGISTRY

DEC 08 2016

ENTERED

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*,
S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT
OF WALTER ENERGY CANADA HOLDINGS, INC., AND THE OTHER PETITIONERS
LISTED ON SCHEDULE "A"

PETITIONERS

ORDER MADE AFTER APPLICATION
(New Walter Group Procedure Order)

BEFORE THE HONOURABLE	)	WEDNESDAY, THE 7TH DAY OF
	)	
MADAM JUSTICE FITZPATRICK	)	DECEMBER, 2016

THE APPLICATION of the Petitioners coming on for hearing at Vancouver, British Columbia, on the 7th day of December, 2016; AND ON HEARING Mary I.A. Buttery, H. Lance Williams and Patrick Riesterer, counsel for the Petitioners and the Partnerships listed on **Schedule "A"** hereto (collectively, the "**Walter Canada Group**"), Peter Reardon and Wael Rostom, counsel for KPMG Inc. and those other counsel listed on **Schedule "B"** hereto; AND UPON READING the material filed, including the 5th Affidavit of William E. Aziz sworn December 2, 2016 (the "**Fifth Affidavit**"), the 6th Affidavit of William E. Aziz (the "**Sixth Affidavit**") sworn December 2, 2016, the Sixth Report of the Monitor dated December 5, 2016 and the Confidential Supplemental Report to the Sixth Report of the Monitor dated December 5, 2016;

THIS COURT ORDERS AND DECLARES THAT:

SERVICE AND DEFINITIONS

1. The time for service of the notice of application for this order is hereby abridged and deemed good and sufficient and this application is properly returnable today.

2. Any capitalized term used and not defined herein shall have the meaning ascribed thereto in the Order of this Honourable Court granted on December 7, 2015 pursuant to *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36, as amended (the "**CCAA**") in respect of the Walter Canada Group (the "**Initial Order**") or in the Fifth Affidavit.

TRANSACTION APPROVAL

3. The sale transaction (the "**Transaction**") contemplated by the Term Sheet among Walter Canada Group, as subject, and 1098138 B.C. Ltd., as purchaser (the "**Purchaser**") and Amacon Land Corporation, as guarantor, made November 28, 2016 (the "**Term Sheet**"), a copy of which is attached as Exhibit "A" to the Sixth Affidavit of William Aziz is hereby approved, and the Term Sheet is commercially reasonable. The execution of the Term Sheet by Walter Canada Group is hereby authorized and approved, and the Walter Canada Group is hereby authorized to take such additional steps and execute such additional documents as may be necessary or desirable for the completion of the Transaction contemplated by the Term Sheet, including the execution of ancillary documents.

TRANSACTION STEPS AND PROCEDURAL MATTERS

4. Each of the members of the Walter Canada Group are authorized but not directed to make an assignment in bankruptcy at such time as the Walter Canada Group determines, in its sole discretion, that it is necessary or advisable to do so.

NEW WALTER ENTITIES

5. The formation of corporations under the British Columbia *Business Corporations Act* to consist of New Walter, New WCCP, New Brule, New Willow Creek and New Wolverine (collectively, the "**New Walter Group**") as provided for by the Term Sheet is hereby authorized and:

   (a) upon formation, New Walter shall issue shares to New WEI, Inc., formerly known as Walter Energy, Inc., such that New Walter will be wholly-owned by New WEI, Inc.;

   (b) upon formation, New WCCP shall issue shares to New Walter, such that New WCCP will be wholly-owned by New Walter; and

   (c) upon formation, each of New Brule, New Willow Creek and New Wolverine shall issue shares to New WCCP, such that each of New Brule, New Willow Creek and New Wolverine will be wholly-owned by New WCCP.

6. The Monitor, on behalf of the New Walter Group and the Walter Canada Group, is authorized to contribute $5 from the Deposit (as defined in the Term Sheet) as payment by the Purchaser, as agent for Walter Energy Inc., of the subscription price for the shares of New Walter and to invest such portion of the $5 on behalf of New Walter in the other members of the New Walter Group as required.

7. The adoption, execution, delivery, implementation and consummation of any matters required to form the members of the New Walter Group involving any corporate action shall be deemed to

have been authorized and approved in all respects and for all purposes without any requirement of any further action by any shareholders and all necessary approvals to take any actions shall be deemed to have been obtained from the shareholders of each member of the New Walter Group, and no vote of or action by any shareholder shall be required to complete the steps contemplated hereby or by the Term Sheet.

8. From and after the date of the formation of the members of the New Walter Group, each member of the New Walter Group shall be and is hereby deemed, upon formation:

(a) to be a debtor company (as defined in the CCAA); and

(b) to be added as a Petitioner in these CCAA proceedings.

9. From and after the date of the formation of the members of the New Walter Group, the provisions of the Initial Order (as amended and extended) shall apply to the each member of the New Walter Group and the Monitor shall be appointed as Monitor of the New Walter Group, with all of the powers, responsibilities and duties set out in the Initial Order and shall be granted and shall continue to have all of the applicable rights and protections. All charges over the Property of the Petitioners granted in these proceedings shall apply equally and with the same respective priority to the Property of each of the members of the New Walter Group (including, for greater certainty, any after acquired property of the New Walter Group and any property transferred to the New Walter Group pursuant to the Term Sheet and the Transaction). For greater certainty, and without limiting the generality of the foregoing, the Administration Charge, the Director Charge and the Success Fee Charge, each as defined and described in the Initial Order and the order of the Court pronounced January 5, 2016 (the "**SISP Order**") (each as amended by any subsequent Order of the Court), shall attach to all Property of the New Walter Group.

10. The Monitor is hereby authorized and directed to file with the Court a certificate substantially in the form attached hereto as **Schedule "C"** indicating the names of each member of the New Walter Group and, following the delivery of such certificate, the style of cause in these CCAA proceedings shall be amended to include the names of the members of the New Walter Group as Petitioners.

11. The Monitor is hereby granted all of the enhanced powers set out in the Order of the Court pronounced August 16, 2016 (the "**Enhanced Powers Order**") with respect to the New Walter Group and is also hereby authorized and directed to:

(a) open such bank accounts or brokerage accounts with such financial institutions as the Monitor, in its sole discretion, deems are necessary or advisable in connection with the exercise of the Monitor's powers, the Transaction, the claims process underway with respect to the Walter Canada Group and any other matter in these CCAA proceedings, including accounts in the name of the Monitor in trust for any member of the New Walter Group and any accounts in the name of any member of the Walter Canada Group;

(b) change the signing authority of any of the foregoing bank accounts or brokerage accounts, including as deemed necessary by the Monitor to facilitate the completion of the Transaction, at such times as the Monitor may determine; and

(c) receive, collect and take possession of all monies, securities or other negotiable instruments of the Walter Canada Group or the New Walter Group.

CHIEF RESTRUCTURING OFFICER

12. BlueTree Advisors Inc. ("**BlueTree**") shall be and shall be deemed to have been engaged to provide the services of William E. Aziz to act as chief restructuring officer ("**CRO**") of the New Walter Group; the CRO Engagement Letter, including any indemnification obligations set out therein, shall apply to the members of the New Walter Group and the New Walter Group shall be "Walter Canada" or the "Company" as defined in the CRO Engagement Letter; and BlueTree and the CRO shall be granted and shall continue to have all continue to have all of the powers, responsibilities and duties set out in the SISP Order and shall be granted and shall continue to have all of the applicable rights and protections set out in the SISP Order, in each case as amended by any subsequent Order of the Court, including the benefit of the Administration Charge and the Success Fee Charge.

13. At the last moment in time before the assignment in bankruptcy of any member of the Walter Canada Group, the appointment of BlueTree and the CRO in respect of such member of the Walter Canada Group shall be and is hereby terminated and deemed terminated and BlueTree and the CRO be and are hereby discharged as of such time and relieved from any further obligations, responsibilities or duties in the capacity of CRO of such member of the Walter Canada Group pursuant to the SISP Order, any other Order of this Court in the CCAA proceedings or otherwise and, notwithstanding any provision of this Order, nothing contained in this Order shall affect, vary, derogate from or amend any of the rights, approvals and protections in favour of the CRO in the SISP Order, any other Order of this Court in the CCAA proceedings or otherwise.

GENERAL

14. Each of the Walter Canada Group and New Walter Group and the Monitor be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order and the Monitor is authorized and empowered to act as a representative in respect of the within proceedings for the purpose of having these proceedings recognized in a

jurisdiction outside Canada, including acting as a foreign representative of the Walter Canada Group and New Walter Group to apply to the United States Bankruptcy Court for relief pursuant to Chapter 15 of the *United States Bankruptcy Code*, 11 U.S.C. §§ 101-1330, as amended.

15. Endorsement of this Order by counsel appearing, other than counsel for the Petitioners, is hereby dispensed with.

THIS COURT REQUESTS the aid and recognition of other Canadian and foreign Courts, tribunals, regulatory or administrative bodies, including any Court or administrative tribunal of any federal or State Court or administrative body in the United States of America, to act in aid of and to be complementary to this Court in carrying out the terms of this Order where required. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Walter Canada Group and New Walter Group and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Walter Canada Group and New Walter Group and the Monitor and their respective agents in carrying out the terms of this Order.

THE FOLLOWING PARTIES APPROVE THE FORM OF THIS ORDER AND CONSENT TO EACH OF THE ORDERS, IF ANY, THAT ARE INDICATED ABOVE AS BEING BY CONSENT:

Lawyers for the Petitioners

DLA Piper (Canada) LLP
(Mary I.A. Buttery and H. Lance Williams)

and

Osler, Hoskin & Harcourt LLP
(Marc Wasserman and Patrick Riesterer)

BY THE COURT

REGISTRAR

CHECKED

SCHEDULE "A"

Petitioners

1. Walter Canadian Coal ULC
2. Wolverine Coal ULC
3. Brule Coal ULC
4. Cambrian Energybuild Holdings ULC
5. Willow Creek Coal ULC
6. Pine Valley Coal, Ltd.
7. 0541237 B.C. Ltd.

Partnerships

1. Walter Canadian Coal Partnership
2. Wolverine Coal Partnership
3. Brule Coal Partnership
4. Willow Creek Coal Partnership

SCHEDULE “B”

COUNSEL LIST	
NAME	PARTY REPRESENTED
Marc Wasserman and Emmanuel Pressman (by phone)	Ontario Counsel to Petitioners
John Sandrelli and Tevia Jeffries	Canadian Counsel to the United Mine Workers of America 1974 Pension Plan and Trust
JEFF SAUNDERS	US Counsel to the United Mine Workers of America 1974 Pension Plan and Trust
Kendall Andersen	Purchaser and Amacon Land Corporation
Neva Beckie	Her Majesty the Queen in right of Canada
SHAWN POISSON	NORTHLAND PROPERTY CORP. /NPC ACQUISITION CORP.
CAITLIN FELL	MONITOR (BY PHONE)

SCHEDULE "C"

Monitor's Certificate

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*,
R.S.C. 1985, c. C-36

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*,
S.B.C. 2002, c. 57

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT
OF WALTER ENERGY CANADA HOLDINGS, INC. AND THOSE PARTIES LISTED ON
SCHEDULE "A" TO THE INITIAL ORDER

PETITIONERS

MONITOR'S CERTIFICATE: NEW WALTER GROUP

RECITALS

A. Pursuant to an Order of the Honourable Justice Fitzpatrick of the British Columbia Supreme Court (the "**Court**") pronounced December 7, 2015 (the "**Initial Order**"), KPMG Inc. was appointed as the monitor (the "**Monitor**") in connection with the CCAA proceedings of the Petitioners.

B. Pursuant to the Order of the Court pronounced December 7, 2016 (the "**New Walter Group Procedure Order**"), the Court authorized the formation of New Walter, New WCCP, New Brule, New Willow Creek and New Wolverine (the "**New Walter Group**") and that the New Walter Group be and be deemed to be Petitioners in the *Companies' Creditors Arrangement Act* ("**CCAA**") proceedings initiated by the Initial Order.

C. The Monitor was directed to file this certificate upon the formation of the entities comprising the New Walter Group.

D. All capitalized terms used but not defined herein shall have the meaning given in the New Walter Group Procedure Order.

THE MONITOR CERTIFIES the following:

1. The New Walter Group, consisting of New Walter, New WCCP, New Brule, New Willow Creek and New Wolverine have been formed and:

    a. "**New Walter**" means ________________.

    b. "**New WCCP**" means ________________.

    c. "**New Brule**" means ________________.

    d. "**New Willow Creek**" means ________________.

e. "**New Wolverine**" means ________________.

2. Pursuant to the terms of the New Walter Group Procedure Order, each of New Walter, New WCCP, New Brule, New Willow Creek and New Wolverine are Petitioners in the CCAA proceedings and are subject to the Initial Order and the style of cause is to be amended to be as follows:

[STYLE OF CAUSE TO BE INSERTED].

This Certificate was delivered by the Monitor at ________ on _______, 2016.

KPMG Inc., in its capacity as Monitor of Walter Energy Canada Holdings, Inc., the other members of the Walter Canada Group and the members of the New Walter Group and not in its personal capacity

Per: ________________________________

Name:

Title:

NO. S-1510120
VANCOUVER REGISTRY

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND

IN THE MATTER OF THE *BUSINESS CORPORATIONS ACT*, S.B.C. 2002, c. 57, AS AMENDED

AND

IN THE MATTER OF THE PLAN OF COMPROMISE AND ARRANGEMENT OF WALTER ENERGY CANADA HOLDINGS, INC., AND THOSE PARTIES LISTED ON SCHEDULE "A"

PETITIONERS

ORDER MADE AFTER APPLICATION

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Fax No. 604.687.1612

Client Matter No. 15375-00001 LZW/sd