Mass Tort Insolvencies: A Catalyst for Change in the Canadian RESTRUCTURING LANDSCAPE

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MASS TORTS IN BANKRUPTCY

Insolvency and restructuring proceedings under Canada's Companies' Creditors Arrangement Act (CCAA) have come a long way over the last 20 or so years. There was a time when a company couldn't hope to benefit from CCAA protection without a clear path to restructuring its business and settling its debts through a plan of arrangement.

As both the case law and legislation evolved and adapted, a simple "germ" of a plan would suffice to allow a debtor to get its foot in the CCAA door. Before long, the "liquidating CCAA" had become mainstream, and debtors were selling all or substantially all their assets—not necessarily on a going concern basis—with little clarity as to whether a plan would be filed. If that were not enough to get the attention of any Canadian turnaround professional who lived through the '90s, the introduction of iron-clad, court-approved releases granted to non-debtor third parties certainly was.

Change, for better or for worse, tends to happen for a reason. Mass tort insolvency cases, while not as prevalent and prominent in Canada as they have been in the United States, have been a significant catalyst for change in the Canadian restructuring landscape. This article takes a high-level, practical look at where things stand and how they got to this point.

Canadian Red Cross Society

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the years, it remains a relatively skeletal piece of legislation. The courts, building on the Supreme Court of Canada's 2010 decision in *Century Services*, have consistently sought to harmonize the rules applicable to large-scale insolvencies under the CCAA and the rules applicable under Canada's more structured Bankruptcy and Insolvency Act. Nevertheless, the system for handling large insolvencies in Canada, including most, if not all, mass tort cases, remains far less codified than the U.S. Bankruptcy Code's Chapter 11.

The result is that Canada's approach to mass tort insolvencies has mainly been driven by the needs and realities of the cases themselves.

It all started in the late '90s, when the Canadian Red Cross Society was faced with a tainted blood scandal that shook Canadians across the country. With billions of dollars in tort claims and thousands of lives lost or affected by tainted blood products, the Red Cross filed under the CCAA in an effort to allow for the orderly transfer of responsibility for Canada's blood supply, the preservation of its disaster relief and crisis intervention services, and compensation for tainted blood victims.

Red Cross was Canada's first mass tort insolvency case and the first in which tort claimants played a key role in a CCAA process. It was also the first CCAA case to see the appointment of representative counsel for tort claimants, paving the way for something that, while not automatic in Canada, has become relatively standard. *Red Cross* was also one of the first cases (if not the first) to allow a substantial asset sale under the CCAA.

Perhaps most importantly, the Red Cross restructuring was a success. Canada's blood system was successfully transferred to new authorities, the Red Cross was able to continue offering its other services to the community, and tainted blood victims were fairly and reasonably compensated in a timely manner. The use of an insolvency process under the CCAA as a means of resolving mass tort and class litigation was legitimized.

Muscletech

Muscletech Research and Development Inc. was one of many North American companies involved in the sale of products containing ephedra, a once popular weight loss drug that was later banned by government regulators after the substance was associated with various health issues, including some deaths.

In the wake of a number of Chapter 11 filings by U.S. companies faced with ephedra-related litigation (*e.g.,* Twin Labs and Metabolife), Muscletech filed for CCAA protection in 2006. By that time, the company had ceased selling ephedra products and had no active business. There were a number of interesting features in the *Muscletech* case, including the full use of Chapter 15 of the U.S. Bankruptcy Code, which was relatively new at the time.

That said, *Muscletech*'s most significant legacy was the introduction of non-debtor third-party releases to Canadian insolvency proceedings. From the start, it was made clear that the purpose of the CCAA filing was to allow for the global resolution of all suits and claims. In what was a novelty at the time, certain non-debtor third parties, including retailers of Muscletech's ephedra products and insurers on both sides of the border, benefited from a stay of proceedings. The global resolution approach was a success, and those non-debtor third parties that funded the plan of arrangement were granted releases.

While it was an important step in the evolution of Canadian insolvency law, *Muscletech* didn't exactly open the floodgates to non-debtor third-party releases. It wasn't until the Ontario Court of Appeal's 2008 decision in *Metcalfe & Mansfield Alternative Investments II Corp* that such releases became generally acceptable across Canada, under the right circumstances. *Metcalfe* involved the restructuring of Canada's asset-backed commercial paper market.

Today, the factors to be considered when seeking a third-party release as part of a CCAA plan of compromise and arrangement are those set out in 2016's *Target Canada Co.*, which built on the cases that came before it. While neither *Metcalfe* nor *Target* were mass tort cases, factors that remain relevant as far as non-debtor third-party releases are concerned are whether:

- The parties to be released are necessary and essential to the restructuring
- The claims to be released are rationally connected to the purpose of the plan
- The plan can succeed without the releases
- The parties being released are contributing to the plan
- The releases benefit the debtors as well as the creditors generally

- The creditors voting on the plan have knowledge of the nature and the effect of the releases
- The releases are fair, reasonable, and not overly broad

Montreal, Maine & Atlantic

Around 1 a.m. on July 6, 2013, a Montreal, Maine & Atlantic (MMA) train with 72 crude oil tank cars derailed in the town of Lac Mégantic, Québec, sparking an explosion that killed 47 people and decimated the downtown core. The unspeakable tragedy set off a complex cross-border insolvency that involved filings under the CCAA, as well as under Chapters 11 and 15 of the U.S. Bankruptcy Code. The authors of this article were involved as monitor and counsel for the debtor, respectively.

It's difficult to distill the MMA case down to a few short sentences. This wasn't the first time class representation orders were issued; it wasn't the first complex, tailor-made claims process; and it wasn't the first time third-party releases were awarded in a Canadian insolvency case. It did, however, bring a level a scrutiny and attention from both the courts and the general population that had not been seen in a Canadian mass tort insolvency case in some time, certainly not since *Red Cross* and the tainted blood scandal.

And, again, it worked. All but one of the 25 non-debtor third parties that were targeted with litigation or were otherwise perceived to share fault for the tragedy contributed approximately CAD $450 million to a fund for distribution to victims, their families, and other creditors with claims linked to the rail disaster. In exchange, they obtained full releases in both Canada and the U.S. (Chapter 11 and Chapter 15). Litigation remains ongoing against the single non-debtor third-party holdout.

Takeaways

There has been plenty of debate over the years surrounding many of the questions, issues, and policy considerations that one would commonly associate with mass tort insolvency cases. The CCAA is designed to rescue insolvent debtors and maximize value for creditors; is it really the best venue for resolving complex litigation? Are structured claims adjudication processes really in the best interest of mass tort plaintiffs? Do third-party releases send the wrong message to potential tortfeasors, giving them an opportunity to escape the full consequences of their actions?

The practical reality, however, is that each mass tort case is exceptional in its own way, and the flexibility of the CCAA has proved to be a useful and appropriate means by which to navigate exceptional situations. Canadian courts have generally agreed on this front, which perhaps explains why concepts like third-party releases, and the factors to be considered when granting them, have been accepted across the country.

That doesn't mean that every mass tort case in Canada gets a golden ticket to a CCAA restructuring. The CCAA grants judges a great deal of discretion, and the issuance of a CCAA initial order is not a given. Québec courts recently refused to issue a CCAA initial order in respect of a group of related religious organizations known as *Collège Servite*, concluding that CCAA protection was inappropriate. It appeared the debtors sought to gain a litigation advantage after years in civil court.

In the U.S., there is more division on issues common to mass tort insolvencies, like third-party releases. In this regard, all eyes are on the Purdue Pharma matter as it continues to make its way through the courts. In fact, there are a number of cases winding their way through U.S. courts that could leave their mark on U.S. bankruptcy law. What remains to be seen is whether any of those developments will creep north of the border, where the case law is more settled and where third-party releases are a tool that courts and professionals are quite comfortable with.

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