Sixth Annual Pan-Canadian Insolvency and Restructuring Law Conference
Monday, September 13, 2010

Employee Representation Orders in Insolvency Proceedings – Recent Ontario Developments

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Introduction

Employees and retirees are arguably the most vulnerable creditors in any insolvency proceeding. When their employer becomes insolvent or bankrupt, employees can be impacted with sudden job loss without adequate prior notice and without the payment of termination or severance pay. Retirees in receipt of pension benefits may be facing reductions to their monthly pension benefits if their pension plan has not been properly funded by the employer at a time of their lives when they are unable to work to generate income. Disabled employees can be hit with the elimination of their monthly disability benefits on which they vitally depend.

Individually, an employee's or retiree's claim against the estate of their employer can be relatively small in comparison to the claims of lenders and other creditors. Collectively,

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however, employee and retiree claims can be very significant and in many insolvencies, can represent one of the highest of all creditor claims.

It is safe to say that the vast majority of individuals or retirees are unable to understand and navigate an insolvency proceeding. Without legal representation their claims will not be advanced nor their interests protected. To counter this imbalance, many Ontario insolvencies, particularly those of major companies, have seen court-ordered employee representation orders issued so that the entire employee creditor population has representation in the proceeding. Such orders provide a significant offset to employees' and retirees' individual vulnerability and exposure to loss. Representation orders implicitly recognize that there are large numbers of individuals who are not before the Court, yet who are profoundly impacted by the proceedings and need representation. Yet in making such orders, the courts also recognize that there is value to the proceeding of having one representative to act for a multitude of individual employee creditors which in turn generates efficiencies for the administration of the estate.

In the past, most employee representative counsel orders were issued on motions brought on the consent of the various parties. The terms of such orders were negotiated prior to the court attendance. Recently, however, the Ontario courts have had to consider contested motions dealing with the appointment of representative counsel. These decisions shed light on the key considerations of the courts in any motion to appoint an employee representative counsel.

This paper will consider three issues that can be distilled from the recent Ontario decisions. The first area involves the factors to consider about whether employee representative counsel is warranted and if so, who should pay the associated legal costs. The second area relates to potential conflicts of interest within the employee group and whether employee/retiree creditors should be sub-divided with each sub-group having their own representative counsel.

The third area is in relation to carriage disputes among competing counsel over which counsel should be appointed representative counsel. For ease of reference, employees and retirees are referred to collectively as "employee creditors" unless noted otherwise.

Jurisdiction of the Court to Make Representation Orders

The jurisdiction of the court to make representation orders has been cited as deriving from two sources: the *Rules of Civil Procedure* as well as section 11 of the *Companies' Creditors Arrangement Act*. In *Nortel Networks Corp,*. Justice Morawetz confirmed that:

> [10] The Court has authority under Rule 10.1 of the Rules of Civil Procedure to appoint representative counsel where persons with an interest in an estate cannot be readily ascertained, found or served.
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> [11] Alternatively, Rule 12.07 provides the court with the authority to appoint a representative defendant where numerous persons have the same interests.
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> [12] In addition, the court has a wide discretion pursuant to s. 11 of the CCAA to appoint representatives on behalf of a group of employees in CCAA proceedings and to order legal and other professional expenses of such representatives to be paid from the estate of the debtor applicant.[2]

A further source would be, in the writer's view, the inherent jurisdiction of the court to manage its own process. However, there seems to be no debate in the caselaw over the court's power to be able to issue such orders.

1.) When Should an Employee Representation Order be Made?

The case of *Police Retirees of Ontario inc. v. Ontario Municipal Employees' Retirement Board* sets out principles relating to the issuance of representation orders in general. This case did not involve a motion to appoint representative counsel in an insolvency proceeding, but a

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[2] *Re Nortel Networks Corp.* [2009] O.J. No. 2166 (S.C.J) at paras 10-12.

motion to appoint an association, the Police Retirees of Ontario ("PRO"), as a representative, and their counsel as representative counsel, to act for certain retired members of the Waterloo Regional Police Force in an action where the retired members claimed entitlement to surplus funds in a pension plan. Justice Kiteley wrote:

> [19] [T]he the test to be applied in considering a request for a representation order is not whether the individual members of the group can be found or ascertained, but rather whether the balance of convenience favours the granting of a representation order instead of individual service upon each member of the group and individual participation in the proceedings. Such an interpretation is consistent with the legislative purpose behind this provision, which is designed to encourage an expeditious means of resolving contentious issues without the cost and expense associated with a Rule 12 order. In analyzing the balance of convenience, I must consider the inconvenience which would be experienced by each party if the representation order were or were not granted.[3]

In the insolvency context, Justice Morawetz in *Nortel* made the following observations when considering whether to appoint employee representatives and counsel in Nortel's CCAA proceedings:

> [13] it is submitted that employees and retirees are a vulnerable group of creditors in an insolvency because they have little means to pursue a claim in complex CCAA proceedings or other related insolvency proceedings. It was further submitted that the former employees of Nortel have little means to pursue their claims in respect of pension, termination, severance, retirement payments and other benefit claims and that the former employees would benefit from an order appointing representative counsel. *In addition, the granting of a representation order would provide a social benefit by assisting former employees and that representative counsel would provide a reliable resource for former employees for information about the process. The appointment of representative counsel would also have the benefit of streamlining and introducing efficiency to the process for all parties involved in Nortel's insolvency.*
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> [14] I am in agreement with these general submissions.
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> [15] The benefits of representative counsel have also been recognized by both Nortel and by the Monitor. Nortel consents to the appointment of KM as the single representative counsel for all former employees. Nortel opposes the appointment of any additional representatives. The Monitor supports the Applicants' recommendation that

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[3] *Police Retirees of Ontario inc. v. Ontario Municipal Employees' Retirement Board* [1997] O.J. No. 3086 (Gen. Div.) at para 19. See also *Ryan v. Ontario Municipal Employees Retirement Board* [2006] O.J. No. 618 (S.C.J.) at para 14.

> KM be appointed as representative counsel. No party is opposed to the appointment of representative counsel.
>
> [16] In the circumstances of this case, I am satisfied that it is appropriate to exercise discretion pursuant to s. 11 of the CCAA to make a Rule 10 representation order.[4] [emphasis added]

The vulnerability of employees in an insolvency proceeding was also referred to in *Fraser Papers Inc*. There were four motions before the court for the appointment of representatives and representative counsel. Two unions were granted representation orders (although without funding) and two law firms brought competing motions for the appointment of non-union employee representatives and representative counsel. In concluding that representative counsel was warranted, Justice Pepall held that:

> [7] Representative counsel should be appointed in this case and I have jurisdiction to do so. Section 11 of the *CCAA* and the Rules of Civil Procedure provide the Court with broad jurisdiction in this regard. No one challenges either of these propositions. The employees and retirees not otherwise represented *are a vulnerable group who require assistance in the restructuring process* and it is beneficial that representative counsel be appointed. The balance of convenience favours the granting of such an order and it is in the interests of justice to do so.[5] [emphasis added]

More recently in *Canwest Publishing Inc.,* Justice Pepall again considered a motion for the appointment of an employee representative and counsel which was opposed by the primary lending agent as well as the monitor. The lending agent argued that the appointment of representative counsel was premature and thus unwarranted. In rejecting those arguments, Justice Pepall referred to the vulnerability of the employees in the company's insolvency proceeding as a key factor supporting the appointment of representative counsel, even where the employees may not be able to recover anything from the debtor:

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[4] *Nortel*, supra, paras. 13-16
[5] *Re Fraser Papers Inc.* [2009] O.J. No. 4287 (S.C.J.) at para 7

> [24] In my view, this watch and wait suggestion is unhelpful to the needs of the Salaried Employees and Retirees and to the interests of the Applicants. *I accept that the individuals in issue may be unsecured creditors whose recovery expectation may prove to be non-existent and that ultimately there may be no claims process for them.* I also accept that some of them were in the executive ranks of the LP Entities and continue to benefit from payment of some pension benefits. *That said, these are all individuals who find themselves in uncertain times facing legal proceedings of significant complexity. The evidence is also to the effect that members of the group have little means to pursue representation and are unable to afford proper legal representation at this time.* The Monitor already has very extensive responsibilities as reflected in paragraph 30 and following of the Initial Order and the CCAA itself and it is unrealistic to expect that it can be fully responsive to the needs and demands of all of these many individuals and do so in an efficient and timely manner. Desirably in my view, Canadian courts have not typically appointed an Unsecured Creditors Committee to address the needs of unsecured creditors in large restructurings. It would be of considerable benefit to both the Applicants and the Salaried Employees and Retirees to have Representatives and representative counsel who could interact with the Applicants and represent the interests of the Salaried Employees and Retirees. *In that regard, I accept their evidence that they are a vulnerable group and there is no other counsel available to represent their interests. Furthermore, a multiplicity of legal retainers is to be discouraged. In my view, it is a false economy to watch and wait. Indeed the time taken by counsel preparing for and arguing this motion is just one such example. The appointment of the Representatives and representative counsel would facilitate the administration of the proceedings and information flow and provide for efficiency.*[6] [emphasis added]

Justice Pepall also highlighted that an employee representation order would generate efficiencies in the proceeding and relieves the Monitor of having to deal with a large group of employee creditors in a proceeding where the Monitor already had substantial responsibilities. Moreover, in the writer's view, a Monitor (as well as a trustee or receiver) is a court-officer with a duty to treat all creditors in an even-handed manner and as such is not a suitable substitute for independent employee representative counsel. Both Justice Pepall's and Justice Morawetz's comments in the cases referred to above indicate that the courts consider the appointment of employee representative counsel an important vehicle not only to assist employee creditors in

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[6] *Re Canwest Publishing Inc.* 2010 ONSC 1328 (S.C.J.) at para 24.

complex proceedings, but also as an aid for the proper and efficient administration of an insolvency proceeding.

The factors considered by the courts when granting representation orders were summarized in *Canwest Publishing Inc.* as follows:

> [21] Factors that have been considered by courts in granting [representation] orders include:
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> - the vulnerability and resources of the group sought to be represented;
> - any benefit to the companies under CCAA protection;
> - any social benefit to be derived from representation of the group;
> - the facilitation of the administration of the proceedings and efficiency;
> - the avoidance of a multiplicity of legal retainers;
> - the balance of convenience and whether it is fair and just including to the creditors of the Estate;
> - whether representative counsel has already been appointed for those who have similar interests to the group seeking representation and who is also prepared to act for the group seeking the order; and
> - the position of other stakeholders and the Monitor.[7]

In the decisions discussed above the question of proposed representative counsel's ability and resources to fulfill their role in the proceeding was not an issue. Counsel expertise, however, is an important factor for the court. It can be expected that the courts will consider - either implicitly or explicitly - the ability of proposed counsel to be able to perform the task of representative counsel, even in uncontested representation motions. Such a consideration was referenced in an unreported endorsement appointing representative counsel (for bondholders, not

[7] *Re Canwest Publishing Inc.*, supra, at para 21.

employees) in *Re Nelson Financial Group Ltd.*[8]. Justice Pepall approved the appointment of representative counsel, but also "directed" that the representative counsel engage a special counsel to provide advice in respect of their mandate and the operation of the CCAA. Her Honour noted that "...it is important that rep counsel in a CCAA proceeding have some CCAA experience". This comment indicates that the courts will not appoint any counsel – even where representative counsel is warranted – and that the court must be satisfied that the proposed counsel has sufficient experience in insolvency matters. Such a consideration is logical and again ties into the court's interest in ensuring that insolvency proceedings proceed smoothly, or at least, as smoothly as possible.

Who Should Pay the Legal Costs?

If the court finds that representative counsel is warranted the question arises is whether the employees' legal costs should be funded by the insolvent debtor or its estate. It is clear that without an assurance of being paid, a proposed representative counsel is unlikely to be able to take a retainer. In negotiated representative counsel arrangements, the legal costs of counsel are typically negotiated as a term of the employee representation mandate. However, if the company, Monitor or other creditors oppose funding then the issue can fall to the court for determination.

While the Ontario courts have shown a willingness to order the funding of employee representative counsel, where the issue is contested the court's approach has been careful to ensure that funding is directed for those employees who would not have representation in the proceeding but for the court-ordered funding. The courts also consider the financial status of the

[8] (2010/06/15) Ontario Commercial List - Court File No. 10-8630-00CL

debtor company or its estate. As well, it has been stated that as a general rule that funding should only be awarded for one representative counsel.

In *Fraser Papers Inc.,* the Communications, Energy and Paper Workers Union of Canada (CEP) applied for funding as representative counsel to represent its former union members who were now retirees. The request for funding for that group of retirees was rejected. Justice Pepall held that:

> [10] … Counsel for the CEP indicated that while it is unclear as a matter of law that the union is bound to represent former members in circumstances such as those facing Fraser Papers, the CEP would represent them with or without funding. *Given Fraser Papers' insolvency, it seems to me that funding by the Applicants should only be provided for the benefit of those who otherwise would have no legal representation.* The request for funding by CEP is refused.[9] [emphasis added]

A similar request for funding by the CEP in an endorsement of Justice Pepall in *Canwest Global Communications Corp.* was also rejected. There were two motions seeking representation orders and funding to represent different former employees of the debtor. In considering the motions, Justice Pepall commented on the importance of avoiding multiple funded representative counsel:

> [19] As for funding, as I indicated in the *Fraser Papers* case, it should only be provided for the benefit of those former employees who otherwise would have no legal representation. Here, CEP intends to represent its current and former members (except for the CH Employees). But for this desire and subject to the agreement of Cavalluzzo LLP to act, there is no principled reason for separate representation. It arises by choice not out of necessity. Furthermore, this is an insolvency. Absent a clear and compelling reason such as the existence of an obvious conflict of interest, the general rule should be that funding by applicant debtors should only be available for one representative counsel. Even if one disagrees with that proposition, in this case, the CMI Entities have paid and intend to continue to pay, amongst other things, salaries, current services and special payments with respect to the defined benefit pension plans and post-employment and post-retirement benefit payments. Based on the materials before me, thee are approximately 9 CEP members who were recently terminated and who have been advised that they will no longer receive salary continuance. In essence, the evidentiary support

[9] *Re Fraser Papers Inc.,* supra, at para 10.

> that might merit a funding request is absent. As noted in the factum of the CMI Entities, if they should change their position with respect to employee related obligations, the need for funding could be addressed at that time. I am also not persuaded that funding should be granted to pay for CEP's costs for outstanding grievances. No one else including the Monitor supports the requested order and I do not believe that it should be granted.[10]

The authority of the court to order funding for representative counsel cannot be ousted by pre-existing contractual agreements. This point was clearly made in *Canwest Publishing Inc.*, where the court confirmed its authority to order funding from the estate of the debtor despite a prior agreement among the parties that stated otherwise:

> [25] The second basis for objection is that the LP Entities are not permitted to pay any of the legal, financial or other advisors to any other person except as expressly contemplated by the Initial Order or with consent in writing from the LP Administrative Agent acting in consultation with the Steering Committee. Funding by the LP Entities would be in contravention of the Support Agreement entered into by the LP Entities and the LP Senior Secured Lenders. It was for this reason that the Monitor stated in its Report that it supported the LP Entities' refusal to fund.
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> [26] I accept the evidence before me on the inability of the Salaried Employees and Retirees to afford legal counsel at this time. There are in these circumstances three possible sources of funding: the LP Entities; the Monitor pursuant to paragraph 3 (i) of the Initial Order although quere whether this is in keeping with the intention underlying that provision; or the LP Senior Secured Lenders. It seems to me that having exercised the degree of control that they have, it is certainly arguable that relying on inherent jurisdiction, the court has the power to compel the Senior Secured Lenders to fund or alternatively compel the LP Administrative Agent to consent to funding. By executing agreements such as the Support Agreement, parties cannot oust the jurisdiction of the court.[11]

2.) Conflicts of Interest within the Employee Group

In an insolvency proceeding different sub-groups of employee creditors can emerge. These can include active employees, retired employees (union and non-union), executives, and disabled employees, among others. These distinctions can give rise to the potential for conflicts among the groups especially when different groups have claims against different pools of assets

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[10] *Re Canwest Global Communication Corp.* October 27, 2009 (Ontario Commercial List) para 19.
[11] *Re Canwest Publishing,* supra, para. 25-26

in an estate. This in turn can lead to the question of whether the employee population should be sub-divided and with each group having separate legal representation. The conflict issue can also be raised in counsel carriage dispute motions where competing counsel allege that they should represent one employee group due a real or potential conflict.

In *Nortel Networks Corp.* Justice Morawetz was confronted with several competing motions for the appointment of different employee representatives and representative counsel. His Honour applied the "commonality of interest" test to approach the question of whether the Nortel employee group should be sub-divided. Justice Morawetz held that:

> [62] Notwithstanding that creditor classification has yet to be proposed in this CCAA proceeding, it is useful, in my view, to make reference to some of the principles of classification. In Re Stelco Inc., the Ontario Court of Appeal noted that the classification of creditors in the CCAA proceeding is to be determined based on the "commonality of interest" test. In Re Stelco, the Court of Appeal upheld the reasoning of Paperny J. (as she then was) in Re Canadian Airlines Corp. and articulated the following factors to be considered in the assessment of the "commonality of interest".
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> > In summary, the case has established the following principles applicable to assessing commonality of interest:
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> > 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test;
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> > 2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.
> >
> > 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate reorganizations if possible.
> >
> > 4. In placing a broad and purposive interpretation on the CCAA, the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
> >
> > 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
> >
> > 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar manner.
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> > Re Stelco Inc., 15 C.B.R. 5th 307 (Ont. C.A.), paras 21-23; Re Canadian Airlines Corp. (2000) 19 C.B.R. 4th 12 Alta. Q.B., para 31.

> [63] *I have concluded that, at this point in the proceedings, the former employees have a "commonality of interest" and that this process can be best served by the appointment of one representative counsel.*[12] [emphasis added]

These factors were applied by Justice Pepall in *Fraser Papers Inc.* in considering the possible sub-division of employee creditors. Her Honour held that a single representative counsel could represent the interests of employee creditors appropriately and that this approach "...avoids excessive fragmentation and duplication and minimizes costs."[13] Is should be noted that in *Fraser Papers Inc.* two unions were also granted motions to represent their former members. The decisions of *Fraser Papers Inc.* and *Nortel Networks Corp.* indicate that the courts are far more inclined to appoint one representative counsel, absent a real conflict of interest, but that the courts will allow a union to separately represent its former members (although probably without funding).

3.) Counsel Carriage Disputes

Different counsel can become involved for clients in an insolvency proceeding through retainers with individual employees or different employee groups. The Ontario cases discussed above have also had to deal with the issue of competing counsel who seek to be appointed employee representative counsel over other counsel. Such disputes can be highly adversarial and can contribute to delay and distraction among the parties and counsel from the main issues at stake in the proceeding. Not surprisingly, the Ontario courts have indicated that the preferred approach to such a dispute is a consensual resolution among counsel. Nevertheless, in *Fraser Papers Inc* and *Nortel Networks* the court was confronted with the carriage issue and set out a number of factors to consider. As Justice Pepall noted *Re Fraser Papers Inc.:*

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[12] *Re Nortel Networks Corp.*, supra, at paras 62-63.
[13] *Re Fraser Papers Inc.* [2009] O.J. No. 4287 (S.C.J.) at para 14.

[11] Turning to the requests of the Steering Committee of Fraser Papers Salaried Retirees Committee which favours the appointment of Nelligan/Shibley and the Committee for Salaried Employees and Retirees which favours Davies, firstly commonality of interest should be considered. In *Nortel Networks Corp. (Re)*[3], Morawetz J. applied the Court of Appeal's decision in *Re Stelco*[4] and the decision of *Re Canadian Airlines Corp.*[5] to enumerate the following principles applicable to an assessment of commonality of interest:

> 1. Commonality of interest should be viewed based on the non-fragmentation test, not on an identity of interest test.
>
> 2. The interests to be considered are the legal interests that a creditor holds qua creditor in relationship to the debtor company prior to and under the plan as well as on liquidation.
>
> 3. The commonality of interests are to be viewed purposively, bearing in mind the object of the CCAA, namely to facilitate reorganizations if possible.
>
> 4. In placing a broad and purposive interpretation on the CCAA, the court should be careful to resist classification approaches that would potentially jeopardize viable plans.
>
> 5. Absent bad faith, the motivations of creditors to approve or disapprove [of the plan] are irrelevant.
>
> 6. The requirement of creditors being able to consult together means being able to assess their legal entitlement *as creditors* before or after the plan in a similar manner.

[12] Once commonality of interest has been established, other factors to be considered in the selection of representative counsel include: the proposed breadth of representation; evidence of a mandate to act; legal expertise; jurisdiction of practice; the need for facility in both official languages; and estimated costs.

[13] Davies is proposing to represent all unrepresented employees, former employees and their successors. In my view, there is a commonality of interest amongst the members of this group. In essence, they engage unsecured obligations. Arguably those proposed to be represented by the unions could also be included, and indeed absent a change of position by the CMAW, former members of the CMAW will be. That said, for the reasons outlined above, I am satisfied in this case that it is desirable to have the unions act for their members and former members if so willing. Indeed, no one took an opposing position.

[14] I am not persuaded that there is a need for separate representation as advocated by the Committee supporting the Nelligan/Shibley retainer. Appointing only Davies avoids excessive fragmentation and duplication and minimizes costs. In addition, no one will be excluded unless he or she so desires. Davies is also the only counsel whose retainer would extend to the CMAW retirees.[14]

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[14] *Re Fraser papers Inc.*, supra, paras. 11-14

The unique context of each insolvency proceeding can also dictate which representative counsel is most suited for the task. For example, in *Fraser Papers Inc.* the fact that one law firm had international offices was considered an important factor in supporting the appointment of that firm as representative counsel since the proceedings had multi-jurisdictional aspects.[15]

Conclusion

Employee creditors are the most vulnerable group in insolvency proceedings and the appointment of employee representative counsel is a way to overcome some of this vulnerability. Recent Ontario cases of contested employee representation orders have set out a number of factors and principles considered by the courts in making representation orders. The recent Ontario cases have shed light on when representation orders are appropriate and whether the fees of counsel should be paid. The courts have also elaborated on how employee creditors should be grouped and the factors of which counsel is then best suited to represent the defined groups in the case of a carriage dispute. From these cases the courts appear more interested in having employee creditors represented in insolvency proceedings both to assist employees and also to improve the administration of an estate.

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[15] *Re Fraser Papers Inc.*, supra, at paras 15-16.