The Confluence of Insolvency and Maritime Law in Canada: Navigating Troubled Waters

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When claims arise against an insolvent shipowner, the resulting confluence of insolvency law and maritime law and their respective procedures can be tricky to navigate. This article provides a basic overview of the two regimes in Canada, and briefly reviews some Canadian jurisprudence addressing the jurisdictional conflict that can arise between the Federal Court of Canada exercising its admiralty jurisdiction *in rem*, and the jurisdiction of the provincial superior courts over insolvency matters

(a) Insolvency Law in Canada

Insolvency law in Canada is set out primarily in two federal statutes, the *Bankruptcy and Insolvency Act* ("BIA")[1] and the *Companies' Creditors Arrangement Act* ("CCAA").[2] Jurisdiction in insolvency matters is given to the superior courts of the provinces.[3]

Like the U.S., among other jurisdictions, insolvency law in Canada differentiates between a stay of proceedings in liquidations, where the race among creditors is stopped to permit an orderly distribution of the company's assets among creditors, and restructurings, in which the purpose of the stay is to permit the financially distressed company to survive as a going concern and avoid liquidating its assets.

Liquidations are generally administered pursuant to the bankruptcy provisions of the BIA. Upon bankruptcy, there is an automatic stay of proceedings against the bankrupt. All of the assets of the bankrupt vest in a trustee in bankruptcy who is responsible for running a claims process and for realizing upon the bankrupt's assets for distribution to creditors. However, it is a general principle of the BIA that the stay does not affect the rights of secured creditors, who can realize against secured assets including by taking foreclosure proceedings, seizing assets, or seeking the appointment of a receiver or receiver-manager either by way of court-appointment or through private appointment under a security agreement.

Restructurings are dealt with both by the BIA, under its proposal provisions and by the CCAA, the latter which is strictly a restructuring statute available to companies owing their creditors in excess of $5.0 million. Both statutes provide for a stay of proceedings, the filing of a plan or proposal, and meetings of affected creditors for voting on the debtor's plan or proposal, followed by court sanction. The stay in restructuring proceedings is very broad and applies to the claims of secured creditors in addition to the claims of unsecured creditors.

In 2009, significant amendments to the BIA and the CCAA came into force, including the adoption in both statutes[4] of a modified version of the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency, which enhanced the cross-border protocols that Canadian courts previously followed. Both statutes permit a debtor

company with its "centre of main interests" in a foreign country to have its foreign bankruptcy proceeding recognized as a "foreign main proceeding" by a Canadian court.

The effect of an order made pursuant to the BIA recognizing the foreign proceeding as a foreign main proceeding is an automatic stay of all proceedings against the debtor in Canada, subject to the exceptions that would apply in Canada had the foreign proceeding taken place in Canada; in other words, the stay will not affect secured creditors in respect of foreign liquidation proceedings, but it will affect secured creditors in respect of foreign restructuring proceedings. Under the CCAA, if an order recognizing the foreign proceeding is made, the court is obliged subject to any terms and conditions it considers appropriate, to grant a stay of all proceedings against the debtor in Canada. Under both statutes, the Court is obliged to cooperated, to the maximum extent possible, with the foreign representative and the foreign court involved in the foreign proceeding.

(b) Canadian Maritime Law

Admiralty jurisdiction in Canada is exercised by the Federal Court of Canada, concurrently with the provincial superior courts.

Canada has not adopted any international conventions on ship arrest. It has its own system for the arrest of property. In practice, the majority of maritime law cases are commenced in the Federal Court, rather than in the provincial superior courts, because the Federal Court's process runs throughout Canada, and it provides litigants with the action *in rem*, being the principal method of enforcing maritime claims in Canada, as in other common law countries whose maritime law is primarily derived from the admiralty law of England.[5]

The arrest of the ship in the action *in rem* places the ship in notional judicial custody pending the posting of bail or adjudication of the claim. Unless circumstances justify otherwise, physical custody of and responsibility for the ship remains in the hands of whomever held it at the time of the arrest. The arresting party must have either a maritime lien or a statutory right *in rem* for a claim in a category specified in the *Federal Courts Act*.

A sistership of the ship against which an action *in rem* brought can also be arrested in Canada with relative ease, provided that it meets certain criteria of common registered ownership. This can be a useful procedural tool for the maritime claimant seeking security for his claim beyond the defendant ship.

It should be noted that fractional ownership is not sufficient to meet the requirement of having the same ownership.[6] The registered ownership of the sisterships must be identical. Moreover the claim of a holder of a maritime lien against a ship would not enjoy the same high ranking status as against the sistership; rather the lien holder would have only "a statutory right in rem with priority similar to that of any creditor who has an ordinary in rem claim" against that sistership.[7]

Assuming that bail is not posted to have the vessel released from arrest, an order for appraisal and sale of the ship normally follows after judgment, or if the arrested vessel is determined to be a deteriorating asset, may occur even before judgment.

The order for sale provides for notice to be given to creditors that *in rem* claims must be filed by affidavit by a certain date or be forever barred. Further procedural orders typically follow, leading to a hearing to determine the entitlement of the various claimants to share in the proceeds of sale including the priorities of the claims relative to one another, the usual order of which is well established under Canadian maritime law.

(c) The treatment of Maritime Liens under Canadian Insolvency Law

The maritime lien constitutes a distinctive feature of maritime law. It has been described by the Supreme Court of Canada as follows:

> Broadly speaking, a maritime lien arises without registration or other formality when debts of a specific nature are incurred by or on behalf of a ship. The lien creates a charge which "goes with the ship everywhere, even in the hands of a purchaser for value without notice, and has certain ranking with other maritime liens, all of which take precedence over mortgages" (citation omitted).
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> The reason for this privileged status for maritime lien holders is entirely practical. The ship may sail under a flag of convenience. Its owners may be difficult to ascertain in a web of corporate relationships … Merchant seaman will not work the vessel unless their wages constitute a high priority against the ship. The same is true of others whose work or supplies are essential to the continued voyage. The Master may be embarrassed for lack of fund, but the ship itself if assumed to be worth something and is readily available to provide a measure of security. Reliance on that security was and is vital to maritime commerce. Uncertainty would undermine confidence. [8]

Canadian law departs from the English law in its treatment of foreign maritime liens. A maritime lien validly created under foreign law will be recognized and given the same priority under Canadian maritime law unless opposed to some rule of domestic policy or procedure which prevents the recognition of the right.

Canadian law was amended in 2009 to give some Canadian necessary suppliers status equivalent to a maritime lien when asserting claims against foreign vessels. Before this amendment, in priority hearings, some foreign necessary claimants which were entitled to lien status under foreign law were being granted a priority over similar Canadian necessary suppliers. The Canadian necessary suppliers ranked only as statutory claims *in rem*. Once the mortgage was paid out from the sale proceeds, they was no money left for these claimants. The amendment was intended to try to level the playing field between some foreign and Canadian necessary suppliers when both were advancing priority claims in Canada.

Maritime lien and ship mortgage holders are considered secured creditors under the BIA. [9] As discussed above, secured creditors are not subject to the stay under the bankruptcy provisions of the BIA, and therefore are entitled to realize on their security as in the same manner as if there was no bankruptcy, including commencing an *in rem* action in Federal Court.

In contrast, claimants with statutory rights *in rem* do not have the status of secured creditors, subject to the Court's equitable jurisdiction to elevate such a claim to be the equivalent of a maritime lien where necessary to prevent an obvious injustice, such as an unpaid ship repair

claimant whose efforts increased the sale value of the vessel for the benefit of the creditors which would otherwise be in priority to the repairer. [10]

(d) Concurrent admiralty and insolvency proceedings

Canadian courts have had to grapple with jurisdictional issues arising when a ship is subject to concurrent proceedings in the Federal Court of Canada and a provincial superior court in a number of cases, including the ones below.

Nanaimo Harbour Link

In Nanaimo *Harbour Link Corporation* v. *Abakhan & Associates (Trustees) Inc.* [11] , the issue before the B.C. Supreme Court was whether the stay of proceedings under the BIA applied to Federal Court of Canada *in rem* proceedings commenced by maritime lien claimants against a catamaran fast-ferry. The claimants were crew members and ship repairers. The crew members asserted that their claim was a maritime lien ranking ahead of the ship's mortgage, and was also a secured claim and was therefore not stayed by the bankruptcy proceeding. The ship repairers asserted statutory rights *in rem* which they sought to elevate to a status *pari passu* with a maritime lien under equitable principles of Canadian maritime law. The mortgagee argued that Canadian maritime law had no application in determining priorities in bankruptcy proceedings.

In deciding the issue before it, the Court addressed the application of the BIA to maritime liens and confirmed that a maritime lien is a secured claim within the meaning of the BIA. The Court found that the seamen were secured creditors within the meaning of the BIA and entitled to an order that the stay of proceedings was not applicable. The Court concluded that the ranking of the priorities and the proof of the maritime claims would be a matter for the Federal Court to determine pursuant to the principles of Canadian maritime law.

Vanguard Shipping

The debtors in the case of *Re Vanguard Shipping (Great Lakes) Ltd. and Vanship Ltd.*[12] were in the business of operating two Great Lakes freighters and filed for and obtained protection under the CCAA. The sale of substantially all of the debtor companies' assets, including the vessels, was approved by Court order following a court-sanctioned sale and investor solicitation process. The purchaser of the assets agreed to assume responsibility for payment of any in rem claims determined to rank in priority to the existing ship's mortgages.

The Ontario Superior Court approved a claims process and procedure within the insolvency proceeding for the determination and resolution of claims against the vessels and the priorities of the claims inter se. One of the interesting features of the claims process order is the appointment of an experienced maritime lawyer as Referee pursuant to Ontario's *Rules of Civil Procedure* to hear and determine the validity, quantum, and priority of claims against each vessel. A procedure to hear the claims was established that was similar to the steps that would be undertaken by a Federal Court when dealing with such a situation.

1. Conclusion

The substantive and procedural law available to creditors of an insolvent shipowner will depend on a variety of factors including whether the claim is maritime or non-maritime, secured or unsecured, and whether the insolvent shipowner is bankrupt or has sought creditor protection to facilitate a restructuring. Undoubtedly, the confluence of maritime and insolvency law will continue to raise vexing issues for maritime and insolvency practitioners alike. Canadian courts can be expected to apply the principles of comity and cooperation when admiralty and insolvency jurisdiction are both engaged.

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[1] R.S.C. , 1985, c. C-3.
[2] R.S.C., 1985, c. C-36.
[3] BIA, s. 183(1), CCAA s. 2(1).
[4] BIA, s. 268-284; CCAA, Part IV, ss. 42-46.
[5] W. Tetley, "Arrest, Attachment, and Related Maritime Law Procedures" (1999) 73 Tul. L. Rev. 1895-1985. None of the provincial superior courts, with the exception of the British Columbia Supreme Court, permit *in rem* proceedings.
[6] *Ssangyong Australia Pty. Co. v. "Looiersgracht*" (1994) 85 F.T.R. 265.
[7] *The Brussel*, (2000) 185 F.T.R. 145.
[8] *Holt Cargo Systems Inc. v. Abc Containerline N.V. (Trustee of)*, [2001] 3 S.C.R. 907
[9] *Holt Cargo, supra; Nanaimo Harbour Link Corporation v. Abakhan & Associates (Trustees) Inc.,* 2007 BCSC 109
[10] *Scott Steel v. Alarissa (The)*, [1996] 2 F.C. 883
[11] *Holt Cargo, supra,* note 9
[12] *Re Vanguard Shipping (Great Lakes) Ltd. and Vanship Ltd*., Ont. S.C.J. Court File No. CV-12-9655