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SCC rules union can pursue successor employer application against interim receiver

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Bankruptcy suspends the economic independence of an enterprise or individual, turning over the operational choices formerly made by the owner to a court-appointed receiver. It is the receivers' responsibility to salvage as many of the business' remaining assets as possible for the benefit of creditors, including the business' unionized employees.

What happens when the rights of unionized employees come into conflict with the overall objective in a bankruptcy – maximizing the ability of creditors to minimize their losses? What level of access to a remedy are those employees entitled? Are they entitled to the same access as other creditors who attempt to challenge a receiver's conduct? These were the issues dealt with in *GMAC Commercial Credit Corporation – Canada v. T.C.T. Logistics Inc.* (July 27, 2006), a decision of the Supreme Court of Canada.

The main issue in *GMAC* was the test applied under s. 215 of the *Bankruptcy and Insolvency Act (BIA)*, the provision which immunizes the conduct of receivers from lawsuits unless prior judicial authorization is obtained. The application of that test is where the aspiring litigant is seeking to assert union rights. Section 215 provides:

> 215. Except by leave of the court, no action lies against the Superintendent, an official receiver, an interim receiver or a trustee with respect to any report made under, or any action taken pursuant to, this Act.

The current judicial approach to granting leave under s. 215 comes from the 1993 decision in *Mancini (Bankrupt) v. Falconi*. Since *Mancini*, the test for balancing the need for protection from litigation for those administering a bankrupt estate, and the right to sue them for this very administration, has been based on precluding frivolous, vexatious or manifestly unmeritorious claims from proceeding. In *GMAC*, the Supreme Court reaffirmed the *Mancini* test and rejected a more complicated and restrictive test where the claimant is a trade union.

BACKGROUND

The case began with the insolvency of T.C.T. Logistics Inc., whose 42 Toronto warehouse employees were represented by the International Wood and Allied Workers Union. *GMAC*, the employer's largest creditor, applied for an order appointing KPMG Inc. as interim receiver. The order appointing KPMG

purported to protect KPMG from being designated as a successor employer and from any employment obligations arising under either provincial or federal legislation.

Due to the rapid deterioration of the warehousing business, KPMG sought to sell the Toronto warehouse as a going concern as quickly as possible. KPMG agreed to sell most of the assets of the warehousing business to Spectrum Supply Chain Solutions Inc., a newly formed company. About one month later, all unionized employees at the Toronto warehouse were terminated by KPMG. Although some of them were later hired by Spectrum, the hiring's were not in accordance with the Union's seniority list.

As a result, the Union applied to the Ontario Labour Relations Board on May 13, seeking a successor employer declaration and other relief under the *Ontario Labour Relations Act, 1995*. The Union's application to the Board was based on its argument that Spectrum had been incorporated for the sole purpose of acquiring TCT's warehousing business and had colluded with KPMG to operate TCT's business at a different location under substantially the same management. Except for the new location, the only major difference between TCT's operations and those of Spectrum was the absence of the Union.

The Union went to bankruptcy court to seek approval under s. 215 of the *BIA* to pursue its claim before the Board, and to strike the terms of the order immunizing KPMG from challenge under provincial or federal laws. While the bankruptcy judge did soften the terms under which KPMG was protected from being designated as a successor employer, he did rule that KPMG was still entitled to this protection. The Judge denied the Union leave to challenge this ruling before the Board.

COURT OF APPEAL: MORE THAN *Mancini*

The Union appealed the judge's ruling to the Ontario Court of Appeal. The Court of Appeal ruled that while the bankruptcy judge had no jurisdiction to determine whether or not KPMG was a successor employer (the court said only the Board had that power) he had not erred in denying the Union leave under s. 215. The majority of the Court held that the traditional *Mancini* test represented too low a threshold when the proposed proceedings were successor employer applications. In the majority's view, an approach was required that took more account of the impact of such litigation on the bankruptcy process.

The revised test proposed by the majority added factors such as the complexity of the receivership; the availability of suitable purchasers; the potential duration of the receiver's operation of the business pending a sale; any arrangements the receiver has made with the Union to accommodate the employees; the likelihood that a subsequent purchaser will be declared a successor employer bound by the obligations under the collective agreement; and the timeliness of the labour board hearing relative to the receiver's temporary operation and ultimate sale of the business. The dissenting judge held there was no reason to apply a stricter test for granting leave for successor employer applications, and that on the *Mancini* test, the union should have been authorized to bring

its application to the Board.

SUPREME COURT: BACK TO *Mancini*

By a majority of seven to one, the Supreme Court of Canada held that there was no reason to depart from the *Mancini* test for successor rights applications. It also sustained the ruling by the Court of Appeal to the effect that the bankruptcy court judge had no jurisdiction to determine the successor employer status of a receiver.

In reasserting the primacy of the *Mancini* test, the Court expressed the view that the test strikes the appropriate balance between the protection of trustees and receivers from the distraction and delay inherent in frivolous actions, and the preservation to the maximum extent possible of the rights of creditors and others as against a trustee or receiver. In this way, *Mancini* requires that there be explicit statutory language before the *BIA* is interpreted to deprive persons of rights conferred under provincial law.

The Court stated that the approach proposed by the majority in the Court of Appeal, in stressing the potential for interference with the maximization of stakeholder value, would necessarily bar some meritorious cases on the basis that other stakeholders would be better off. In the Court's view, the integrity and efficiency of the bankruptcy process are sufficiently advanced by directing bankruptcy courts to deny leave to frivolous and merely tactical suits. The Court then asked whether there was any reason to adopt a different standard for trade union challenges to a receiver's actions because of the potential impact on other stakeholders, and held there was not:

> If the argument is that the receiver should be protected from the threat of litigation by the Union because of its inevitable cost, delay and inconvenience, then no creditor should ever be granted leave to sue. No litigation is without delay, cost and inconvenience. But Parliament has nonetheless decided, through s. 215, that the bankruptcy court should, in its discretion, permit litigation against court-appointed officers. It has made no distinction between unions and other creditors in granting this discretionary authority and none should be imputed.
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> To impose a higher s. 215 threshold when it is a labour board issue is to read into the *Bankruptcy and Insolvency Act* a lower tolerance for the rights of employees represented by unions than for other creditors. I see nothing in the Act that suggests this dichotomy.

There was no reason, the Court stated, to interpret s. 215 to create enhanced protection for those who violate labour rights. In this case, the Union had sought to argue before the Board that the interim receiver became the employer of the employees after its appointment when it decided to employ them in order to continue operating the warehouse. They argued that as an employer, KPMG was obliged to abide by the collective agreement and applicable labour and employment statutes. The Union alleged it failed to do so by, among other acts, manipulating the sale agreement so that

the Union was ousted from Spectrum's workforce. While it was not clear how the Board would deal with this particular claim, since the outcome would be determined by the facts, it could not be said that the Union's claim was frivolous or based on no evidence. Accordingly, the Court held, it should be allowed to proceed.

In Our View

As a postscript, the Court noted that while it was common practice to provide no notice to the Union of the motion appointing an interim receiver, the result was to exclude the union from the earliest possible opportunity to participate in the formulation of the plan for dealing with the debtor's assets. Acknowledging that including the Union in early discussions may not eliminate a subsequent claim for successor employer liability, they could potentially yield a greater possibility for resolution than ignoring them would. Such discussions, the Court stated:

> […] would have resulted, in this case, in the immediate integration of a significantly affected party into the development and supervision of the orderly, fair and effective management of the insolvency process. It would not, of course, necessarily have avoided a multiplicity of proceedings. Nor would it have guaranteed the Union's blessing of the proposed methodology for preserving and realizing the assets. But it would have, at the very least, ensured that its legitimate concerns were factored into the planning at an early enough stage, thereby possibly avoiding later proceedings such as those which arose in this case.

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