Restructuring and Insolvency

Doing Business In Canada

Restructuring and insolvency law in Canada is primarily governed by two pieces of federal legislation: the *Companies' Creditors Arrangement Act* (the "**CCAA**") and the *Bankruptcy and Insolvency Act* (the "**BIA**"). Insolvency is a matter of federal jurisdiction and therefore these statutes are applicable throughout all provinces in Canada. The determination of creditor claims and creditor rights, however, often involves provincial law and therefore will vary between provinces, particularly Québec which has a significantly distinct creditor rights regime.

The CCAA is Canada's primary reorganization statute for large companies; however, it may also be used to achieve a liquidation of assets. The BIA provides for (i) the reorganization of an insolvent company through a proposal proceeding; (ii) the appointment of a Receiver at the request of a secured creditor over the assets of an insolvent company; and (iii) the bankruptcy of an insolvent company (being a liquidation of a company's assets and a distribution of proceeds to creditors). The *Winding-Up and Restructuring Act* — a separate piece of federal legislation — applies to the insolvencies of banks, trust companies and insurance companies.

The BIA provides that a corporation is insolvent if (i) it is unable to satisfy its obligations generally as they become due; (ii) it has ceased paying its obligations in the ordinary course of business (collectively (i) and (ii) are known as the 'cash flow test'); or (iii) if its assets, disposed of at a fairly conducted sale under legal process, would be insufficient to satisfy all liabilities due and accruing due (known as the 'balance sheet test'). Case law under the CCAA has adopted the BIA's definition of insolvency but has relaxed the definition to provide that if it is likely that the corporation will be insolvent on a cash flow basis in the reasonable future, it will also be held to be insolvent for purposes of the CCAA.

Reorganizations (under both the CCAA and BIA), the appointment of a Receiver, the liquidation of assets in a bankruptcy, reviewable transactions and the recognition of foreign insolvency proceedings are discussed below.

An important feature of each of Canada's insolvency regimes is the role played by a licensed trustee in bankruptcy. A licensed trustee in bankruptcy has a different role in each proceeding (namely, as a "Monitor" in a CCAA proceeding, as a "Proposal Trustee" in a bankruptcy proposal, as a "Receiver," as a "Bankruptcy Trustee" or as an "Information Officer" in a foreign recognition proceeding). In such roles, the licensed trustee in bankruptcy acts as a court officer with certain statutory and other duties as set out by the Court. As a court officer, the Court typically gives a great deal of weight to the views of the Monitor, Proposal Trustee, Receiver, Trustee in Bankruptcy or Information Officer on issues in the proceeding.

Reorganization

As noted above, both the CCAA and the BIA contain debtor-in-possession reorganization regimes. Corporations who (i) have obligations in excess of $5 million (alone or in conjunction with related entities seeking protection) and (ii) are incorporated under the laws of Canada or a province or have assets in Canada or do business in Canada are eligible to seek protection under the CCAA. Insolvent corporations who are incorporated under the laws of Canada or a province are authorized to carry on business in Canada or have an office or property in Canada are eligible to seek protection to attempt to reorganize by filing a proposal or a notice of intention to make a proposal (an "**NOI**") under the BIA.

Current as of May 2017

The CCAA and the BIA proposal sections contain many similar provisions. For example, each provides for (i) the approval of debtor-in-possession financing; (ii) the granting of priority charges for administration costs, debtor-in-possession financing and director's liabilities; (iii) the forced assignment of agreements; (iv) the disclaimer or repudiation of agreements; (v) prohibitions on sales of assets out of the ordinary course of business without Court approval of such sale(s); (vi) the postponement of equity claims; (vii) the preservation of intellectual property licenses; and (viii) voting thresholds on plan or proposal to put creditors.

In addition, both the BIA proposal sections and the CCAA contain provisions which permit certain claims against directors to be stayed during proceedings and compromised in a proposal or plan. As well, in order to encourage directors to remain in a restructuring proceeding, both statutes provide the Court with the ability to order that the debtor company indemnify the directors for any obligations which they may incur following initiation of the proceedings and grant a charge over the debtor company's assets as security for such indemnity in priority to other creditors.

However, there are some significant differences between the two reorganization regimes. Generally speaking, the BIA proposal provisions are seen as much more rule based and less flexible than the CCAA. The CCAA, on the other hand, is a more court-driven process that provides a great deal of flexibility, but it is viewed as more expensive. The CCAA is typically used for more complex corporate proceedings.

CCAA Reorganization

A CCAA proceeding is commenced by application to the Court in the province where the debtor company's head office or principal place of business is located. The initial application is typically made by the debtor corporation, but may be made by a creditor. It must be accompanied by substantial evidence to support the broad ranging relief sought. Specifically, the CCAA requires that a weekly cash flow projection be filed with the Court along with all the financial statements (audited and unaudited) prepared in the last year, or if none were prepared in that time period, the most recent financial statements.

Upon the Court declaring that a corporation is entitled to protection under the CCAA, the Court may make an order staying proceedings against the company on such terms as the Court finds appropriate. It is typical that a very broad stay of proceedings be granted by the Court, but the scope of such stay is within the Court's discretion. As with a BIA proposal proceeding, exemptions to the initial stay for regulatory bodies and eligible financial contracts exist. The initial stay under the CCAA can be for a maximum of 30 days. Following the initial 30 day period, however, there is no limit on the length or duration of the stay extensions granted by the Court.

Upon the granting of an initial order under the CCAA, the Court is required to appoint a Monitor to act as the Court's officer. The Monitor's role is similar to that of a Proposal Trustee in the BIA proposal proceeding, but often the CCAA court order will provide the Monitor with additional powers or duties. Although the CCAA is primarily a debtor-in-possession statute, in certain circumstances the powers of management have been transferred to the Monitor by court order. As noted above, the CCAA is a very flexible statute and in large part governed by the various court orders made within the proceeding.

The CCAA contains no detailed statutory claims process, rather the process of calling for claims, adjudicating claims and barring claims not filed is established by court order.

The debtor company, with the assistance of the Monitor, may put forward a plan of compromise or arrangement to the Court. There are certain required payments which must be provided for in the plan (i.e., certain wages, benefit payments and tax payments). Subject to certain statutory restrictions, the plan may contain any provision that a legal contract may contain. Plans may involve creditors accepting various forms of compromise to the immediate payment of their claim, including a reduced payment, payment over time, a debt for equity conversion or other compensation.

The Court initially reviews the plan and may accept it for filing and distribution to the creditors if it meets the requirements set out in the CCAA. A court order approving a plan for filing typically establishes rules regarding the calling of a creditors' meeting for a vote on the plan. A plan may be put to one or more classes of creditors, both secured and unsecured. Each class must individually vote on the plan. To be accepted by the creditors of a class the plan must be approved by more than 50% of the creditors voting on the plan (in person or by proxy) who represent 2/3 in value of those creditors voting. A creditor related to the debtor company may vote against, but not for, a plan.

The plan is only binding on those classes who approve the plan once sanctioned by the Court. There is no ability for one class of creditors to 'cram down' a plan on another class of creditors. Following the approval of the plan by the creditors, it must be brought to the Court for sanction (the Court's final confirmation of the plan).

BIA Reorganization

Unlike a CCAA, a BIA proposal proceeding does not commence with a Court application. It is possible to commence a BIA proposal proceeding by filing a proposal, but it is much more common to initially file an NOI. The proposal or the NOI are filed electronically by the proposed Proposal Trustee with the Office of the Superintendent of Bankruptcy.

The filing of the NOI or the proposal triggers a stay of proceedings against the debtor corporation, the scope of which is set out in the BIA. Generally, all unsecured and secured creditors are caught by the stay. However, the stay does not apply to a secured creditor who, more than 10 days prior to the filing of the NOI or proposal, gave the debtor corporation notice of its intention to enforce security in the prescribed manner (as discussed further below).

The initial stay upon filing of an NOI is 30 days, but may be extended by the Court on application of the debtor company in increments of 45 days at time to a maximum stay period of six months.

As with a CCAA plan, the BIA contains provisions mandating certain payments in a proposal, but otherwise, a proposal may contain any term that could otherwise be in a contract. A proposal must be made to at least one class of unsecured creditors, but can also be made to a class or classes of secured creditors. Once a proposal is filed, the Proposal Trustee is required to send the proposal to known creditors along with a report on the proposal and notice of a meeting where a vote will be held on the proposal.

Similar to a CCAA, to be approved by a class of creditors, the proposal must be approved by creditors holding a majority in number and more than 2/3 of the value of the claims voting. Creditors who are related to the debtor corporation are only entitled to vote against, but not for, the proposal. If approved by the requisite majorities of voting creditors, the proposal must be approved by the Court and once approved must be implemented.

During the proposal proceeding, the BIA contains certain additional requirements that must be met (i.e., a cash flow must be filed within 10 days after filing the NOI. If at any point in time the debtor company fails to file the required material, if the stay of proceedings is not extended upon its expiry, or if the proposal fails to achieve the required majority votes or court approval, the debtor company is automatically deemed bankrupt. In contrast, under a CCAA proceeding, there is no deemed bankruptcy.

Secured Creditor Enforcement

Where the debtor is in default under a security agreement, the secured party has:

- The rights and remedies provided in the security agreement;
- The rights and remedies under provincial legislation governing personal property collateral (typically called the "*Personal Property Security Act*" or "**PPSA**");
- Rights and remedies under provincial legislation governing real property and mortgages;
- Rights under the BIA or certain provincial laws to apply to the Court for the appointment of a Receiver over the debtor's property and undertaking; and
- The right to commence an action to recover arrears of payment or compel specific performance of a contract (and to do so without terminating or otherwise triggering other provisions of the security agreement, unless the secured creditor chooses to do so).

However, pursuant to the BIA, subject to certain exceptions, before a secured creditor may enforce against all or substantially all of the inventory, accounts receivable or other property used by an insolvent debtor in the operation of its business, the secured creditor must provide the debtor with 10 days notice of its intention to enforce its security in a prescribed form. The debtor may waive the 10-day notice period, but only after the notice has been delivered.

Personal Property Security

Other than the personal property security regime in Québec which is significantly different, most PPSA statues typically provide a secured party with five main rights in connection with personal property collateral:

- Collection Rights: A secured party is entitled to notify any person obligated on an account or on chattel

paper or any obligor on an instrument to make payment to the debtor to re-direct such payments to the secured party (akin to a garnishment). The secured party is also entitled to take control of any proceeds to which the secured party is entitled under the PPSA.

- Possession upon Default: The secured party has, unless otherwise agreed, the right to take possession of the collateral by any method permitted by law. If the collateral is equipment and the security interest has been perfected by registration, the secured party may, in a reasonable manner, render such equipment unusable without removal thereof from the debtor's premises, and the secured party shall thereupon be deemed to have taken possession of such equipment.
- Disposition: Upon default under a security agreement, the secured party may dispose of any of the collateral, subject to the requirements of the PPSA.
- Foreclosure: The secured party has the right — subject to the objection of other interested parties — to retain the collateral in full satisfaction of the obligation following default. When the secured party exercises this right, it operates as a voluntary legislative foreclosure. While they may also pursue a judicial foreclosure, this step is rarely taken.
- The Right to Enforce a Secured Interest by Any Method Permissible by Law: This may include issuing a statement of claim or bringing a motion or application for injunctive relief (such as an interim order to recover collateral), or by using self-help remedies (such as electing to constructively seize the collateral, taking legal but not physical possession).

The PPSA, however, qualifies the rights of secured parties by imposing a duty of reasonable care on those creditors having possession of a debtor's collateral (either directly or indirectly through the appointment of a Receiver). A secured party shall use reasonable care in the custody and preservation of collateral in its possession. A secured party is required to keep the collateral identifiable, but fungible collateral may be commingled. Unless otherwise agreed or where the collateral is an instrument or chattel paper, "reasonable care" includes taking necessary steps to preserve rights against prior parties. In exercising this duty, reasonable expenses (including the cost of insurance and payment of taxes and other charges incurred in obtaining and maintaining possession of the collateral and in its preservation) are chargeable to the debtor and are secured by the collateral held. The secured party may hold as additional security any increase or profits, except money, received from the collateral, and money so received, unless remitted to the debtor, shall be applied against the debt owing.

Real Property Security

In Ontario, mortgagees have three primary avenues for disposal of property when a mortgagor defaults on their mortgage payments:

- Contractual power of sale provisions;
- Statutory power of sale; and
- Foreclosure remedies.

Power of sale provisions allow a secured creditor to realize the secured collateral faster and with fewer hurdles. It is common for a privately appointed Receiver (acting for the mortgagee) to sell mortgaged real property pursuant to the power of sale provisions contained in the mortgage and under provincial law. Further, to make the sale of the mortgaged property easier, the mortgage will also often give the mortgagee the right to obtain an order directing certain parties occupying the property to leave the property so that the mortgagee has possession of the property free of any interference from others, including the mortgagor or related parties (called an order for possession).

In order to complete statutory power of sale proceedings or a foreclosure, the mortgagee must provide certain prescribed notices to prescribed parties, which afford the mortgagor and other interested parties certain protections, including the right to redeem the security.

Real property security enforcement varies by province and power of sale remedies are not available in all provinces. In other provinces judicial foreclosure proceedings are common.

Receivership

In Canada, the most common method for a secured creditor to enforce its security against a debtor is through the appointment of a Receiver.

Receivership is a process in which a company and its assets are placed under the control and management of a

Receiver (a licensed trustee in bankruptcy) with the ability to continue to operate the business to maximize value for the stakeholders. Although a Receiver may be appointed “privately” pursuant to rights under a security agreement, more often a creditor will seek the appointment of a Receiver by the Court which provides the Receiver with greater powers and protections. Although a court-appointed Receiver may be appointed at the behest of a secured creditor, once appointed the Receiver has a duty to act in the best interest of all creditors and is a court officer. In this case, the scope of a Receiver’s appointment and their powers are established by court order and often vary.

Typically, the primary objective in a receivership is to obtain a stay of proceedings in order to allow the Receiver to complete an orderly liquidation of the debtor’s property and assets, which may include a sale as a going concern or a piecemeal liquidation of the assets. Accordingly, in the court order appointing the Receiver, the Receiver is typically provided with the power to continue to operate the business, including retaining employees and entering into contracts on behalf of the debtor, if the Receiver believes that it will maximize the value of the assets for the creditors. Generally speaking, the structure and options for the sale process to be conducted by the Receiver are similar to the CCAA, with the most notable difference being that the Receiver makes the decisions in place of company management/board.

Bankruptcy

As noted above, bankruptcy (i.e., liquidation) is governed by the BIA. Bankruptcy is a statutory process typically used to shut down an insolvent debtor company, liquidate its assets and distribute any proceeds to unsecured creditors. The bankruptcy may be initiated (i) voluntarily by the debtor filing of an assignment in bankruptcy, (ii) involuntarily by a court application by one or more creditors seeking a bankruptcy order against the debtor, or (iii) automatically if a debtor corporation fails to successfully complete a step in a BIA proposal proceeding. In each case, subject to the rights of secured creditors all of the debtor’s assets and undertaking vest in a licensed trustee in bankruptcy, all employment contracts are automatically terminated and the company’s management and board relinquish all power and control.

The vesting of the assets in the Bankruptcy Trustee and the administration of the bankruptcy estate is, as noted, subject to the rights of secured creditors. Therefore, the secured creditors are free to enforce/realize on the assets themselves, including through a private or court-appointed Receiver. The Bankruptcy Trustee can however require secured creditors to “prove” their security and can elect to redeem the security; namely, pay out the debt owed to the secured creditor in order to realize on the assets itself for the benefit of the unsecured creditors. Redemption of the security is rare but may be desirable to the Bankruptcy Trustee if the value of the assets are significantly greater than the secured debt.

Upon its appointment, the Bankruptcy Trustee must call a first meeting of creditors within 21 days of the bankruptcy. At the first meeting of the creditors, the creditors may appoint up to five inspectors of the bankrupt estate or agree not to appoint any inspectors. The inspectors are empowered to oversee and direct the actions of the Bankruptcy Trustee, including with respect to any sale of assets by the Bankruptcy Trustee (subject to certain exceptions).

Regardless of whether the Bankruptcy Trustee has inspector approval of a sale, the Bankruptcy Trustee must still exercise reasonable discretion and act in good faith in making a sale of estate property and must ensure the sale is made in a commercially reasonable manner. The Bankruptcy Trustee may also apply to the Court for directions if it is unsure as to the best way to proceed or it appears that there may be disputes over the proposed sale.

The BIA also provides for a priority scheme for the distribution of assets by a Bankruptcy Trustee. Certain priorities (in some cases even over secured creditors) are given to unpaid wages, missed pension payments, unpaid farmers or fisherman and unpaid source deductions. Limited rights of repossession are also given to unpaid suppliers who have delivered goods in the 30 day period before bankruptcy. Although unsecured creditors generally share rateably, the BIA does provide for certain preferred unsecured creditor claims (i.e., landlords for up to three months of rent) and certain postponed claims (i.e., equity claims). A levy on all distributions made by a Bankruptcy Trustee is also payable to the Office of the Superintendent of Bankruptcy.

Reviewable Transactions

In Canada, authority for the avoidance of transactions is contained in both federal and provincial legislation.

Although the federal and provincial provisions are similar they are not identical, and thus differences may arise depending on the location of the debtor.

Challenges to transactions under both federal and provincial statutes fall primarily, but not exclusively, into two categories: (i) preferences and (ii) fraudulent transfers or transfers at undervalue. Certain transactions may satisfy the requirements of both categories and may be avoidable under multiple statutes. An improper transaction that falls within these categories may be set aside or damages may be awarded against the benefiting party and/or against directors of the debtor in some situations.

Preferences involve the transfer of property with the effect of benefiting one creditor over another. By contrast, fraudulent conveyances and transfers at undervalue are concerned with transactions that are designed to hinder the collection efforts of creditors or transfer assets away from the debtor without proper consideration and therefore apply to dealings with all parties, not just creditors. Fraudulent transfers/transfers at undervalue arise where no consideration is received by the debtor or where the consideration received is conspicuously less than the fair market value of the consideration given by the debtor, and apply to both the transfer of property or the provision of services by the debtor. While a preference is exclusively an insolvency related remedy, a transfer at undervalue/fraudulent transfer, in some of its statutory forms, may encompass solvent debtors outside of bankruptcy and restructuring proceedings.

The BIA establishes certain look back periods for which a Bankruptcy Trustee is given additional powers to claw back money into the bankruptcy estate for both preferences and transfers at undervalue. These look back periods vary and may be up to five years depending on the circumstances and whether related parties are involved.

Other types of actions to avoid improper transfers include actions under the business corporations statutes that allow for broad and equitable remedies to prevent, rectify or recover losses in connection with inappropriate transactions or oppressive conduct by a company, its controlling shareholders or directors.

Foreign Recognition

Canada has incorporated into both the CCAA and the BIA a modified version of the United Nations Commission on International Trade Law (UNCITRAL) model law on cross-border insolvency. In many respects, therefore, international recognition of foreign insolvency proceedings in Canada is similar to Chapter 15 of the US Bankruptcy Code.

In brief, an authorized foreign representative in the foreign insolvency proceeding may bring an application to the Canadian Court for recognition of a foreign proceeding. The Canadian Court must determine if the foreign proceeding is a foreign main proceeding or a foreign non-main proceeding. If the debtor company's center of main interest (COMI) is located in the jurisdiction of the foreign proceeding, the proceeding will be recognized as a foreign main proceeding. Once recognized as a foreign main proceeding, the Canadian Court is required to grant a limited stay of proceedings in respect of the debtor company. If the foreign proceeding is recognized as a foreign non-main proceeding, there is no automatic stay, but rather the relief granted is in the discretion of the Canadian Court.

Upon recognition of a foreign proceeding, the CCAA and BIA require the foreign representative to take on certain obligations, including the posting of notices related to the foreign proceeding. As well, although not required by the statute, it is typical that a Court will require the appointment of an Information Officer to monitor and report to the Court on the status of the proceedings.

Once a foreign proceeding is recognized, the Canadian Court is to cooperate to the maximum extent possible with the foreign representative and the foreign Court. However, nothing in the foreign recognition provisions of the CCAA or BIA prevents the Canadian Court from refusing to do something that would be contrary to Canadian public policy.

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