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Bankruptcy and Restructuring



1. Legislation and Court System

The Canadian bankruptcy and insolvency regime is divided between the federal and provincial levels of government in accordance with the division of powers set out in Canada's Constitution. The federal Parliament has authority over bankruptcy and insolvency while the provincial legislatures have authority over securities laws, property and civil rights,

including the responsibility for determining the rights and remedies of secured creditors. The result is that various pieces of legislation at both the federal and provincial levels may apply to businesses involved in an insolvency.

The federal statutes primarily governing insolvency proceedings are:

- The *Bankruptcy and Insolvency Act* (BIA), which sets out Canada's bankruptcy regime and is the statute used to liquidate a business. It also provides a proposal regime to allow debtors to reorganize and reach compromises with their creditors;
- The *Companies' Creditors Arrangement Act* (CCAA), which is strictly a restructuring statute and sets out a framework for the reorganization of insolvent companies with debts totalling over \$5 million. It provides for plans of arrangement to allow debtors to reach compromises with their creditors or a sale of the business under the supervision of the court; and
- The *Winding-up and Restructuring Act* (WURA), which is used primarily to wind up regulated bodies such as banks, insurance companies and trust corporations.

The principal provincial statutes affecting insolvency proceedings are:

- The *Personal Property Security Act* (PPSA); and
- The *Courts of Justice Act*, *Judicature Act* and *Rules of Civil Procedure* (Rules of the Court).

All common law provinces have enacted PPSA legislation that establishes a regime for creating valid security interests, determining priorities among creditors and enforcing security interests. This legislation is similar to the various Uniform Commercial Codes in effect in many jurisdictions in the United States. In Québec, however, creation of security interests and determina-

tion of priorities is determined by the provisions of the *Civil Code of Québec*. Registration is made in the Register of Personal and Movable Real Rights. For more information on PPSA legislation, see Section D, "Secured Financing."

Unlike the United States, Canada does not have a separate Bankruptcy Court. Rather, the BIA and CCAA assign jurisdiction to provincial courts over which federally appointed judges preside. These courts are of general jurisdiction. However, some provincial courts have established commercial court branches in which insolvency proceedings are commenced. In Ontario, judicial authorities have established a specialized branch called the "Commercial List." Insolvency proceedings move relatively quickly through the Ontario Commercial List due to its limited mandate. Being federal enactments, both the BIA and CCAA contain provisions requiring orders made by one provincial court to be recognized and enforced by other provincial courts.

2. Restructuring

A restructuring of a corporation's debt, or a "workout," usually occurs in one of two ways: informally without court process by agreement between the debtor and its creditors; or formally under either a proposal as outlined in Part III of the BIA or a plan of arrangement under the CCAA.

a. Commencing Restructuring Proceedings Under the BIA and CCAA

A proposal under the BIA or a plan of arrangement under the CCAA is effectively a contract between an insolvent debtor corporation and its creditors. In either case, the debtor makes a written offer to settle the provable claims of various classes of its creditors. A CCAA plan of arrangement can be made with any particular class or classes of creditors, whereas a proposal under the BIA must include an arrangement with the corporation's preferred creditors (which includes claims of the trustee, employee claims and landlord claims) and unsecured creditors. In both cases, various classes of secured creditors may be included. Any class of creditors not included cannot be bound by the plan or arrangement.

In order to facilitate successful restructurings, the CCAA and BIA provide for a stay of proceedings against a debtor corporation by its creditors, although the CCAA stay is often broader in scope. Both statutes also allow the debtor corporation to remain in possession of its assets during the restructuring process and provide for interim financing to the debtor corporation, known as "debtor-in-possession" financing, or "DIP" financing. Lenders providing DIP financing are eligible for "super priority" security over the debtor's assets. Both statutes have been updated to contain specific guidelines for determining the classification of creditors.

The BIA and the CCAA set out a two-stage approval process. Creditors in each class vote on the proposal or plan of arrangement. The threshold for voter approval is majority in number and two-thirds in value of the claims of each class voting in person or by proxy. If this threshold for approval is reached, an application is made to the court for approval of the proposal or plan of arrangement.

Both the BIA and CCAA provide for a neutral party to monitor progress of the restructuring of the debtor. Under the BIA, a proposal must provide for the appointment of a trustee who has a general duty to monitor

the debtor's business and financial affairs during the restructuring and to report on any material adverse changes. The trustee must also report on the reasonableness of the debtor's cash flow statement.

Similarly, the CCAA requires the appointment of a monitor who must be a licensed trustee in bankruptcy. The monitor carries out a role similar to that of the trustee under the BIA and is responsible for assisting the debtor in dealing with management of the business during the restructuring, assisting with preparation of the plan of arrangement, or assisting with a sales process. The monitor must also file periodic reports with the court and creditors and has recently become more involved in the entire restructuring process.

b. Differences Between BIA and CCAA Restructurings

Despite the similarities between the BIA and CCAA, there are differences that should be taken into account.

Benefits of proceeding under the CCAA include:

- Due to the generally liberal judicial approach to the interpretation of the CCAA and the lack of detailed rules of procedure, the CCAA offers significantly more flexibility to a debtor corporation than proceedings under the BIA;
- There is no statutory time limit for filing a plan under the CCAA, whereas the BIA sets a maximum period of only six months to file a definitive proposal;
- Under the CCAA, the court has the discretion to make third parties who are not creditors of the debtor subject to the stay of proceedings during the restructuring period; and
- Under the BIA, if the unsecured creditors reject a proposal or the court refuses to approve it, the debtor corporation is automatically declared to be bankrupt. Rejection of a plan of arrangement under the CCAA does not have this automatic effect.

Benefits of restructuring under the BIA include:

- A stay of proceedings under the BIA is obtained by filing a notice of intention with an administrative officer, while under the CCAA, a stay must be obtained by seeking a court order;
- The CCAA applies only to corporations or corporate groups with an aggregate of at least \$5 million in debt; the BIA has no such restriction; and
- Since the BIA contains a detailed code of procedure for restructurings, which is absent from the CCAA, and mandates a shorter time frame, costs are lower in a proposal under the BIA, as fewer court applications are required.

c. Cross-border Insolvencies

The BIA and CCAA outline procedures for cross-border insolvencies. These provisions are set out in a modified version of the United Nations Commission on International Trade Law's (UNCITRAL) Model Law on Cross-Border Insolvency and have worked well in practice.

3. Receiverships

The BIA provides for the enforcement of security and the appointment of receivers. A secured creditor planning to enforce its security on all or substantially all assets of an insolvent debtor must give prior notice of this intention and wait 10 days after sending the notice before taking further steps, unless the debtor consents to an earlier enforcement. Next, a receiver is appointed. The receiver must give notice of its appointment to all creditors, issue reports on a regular basis outlining the status of the receivership and prepare a final report and statement of receivership accounts when the appointment is terminated. These reports are available to creditors upon request.

A receiver, or receiver and manager, is appointed in one of two ways: privately, by a secured creditor in accordance with a security instrument, or by a court order.

a. Private Appointment of a Receiver

Where a security agreement provides for the private appointment of a receiver, the powers of the receiver must also be set out in that instrument.

Unlike a court-appointed receiver, a private receiver's loyalties lie with the creditor that appointed it, and it will work to maximize recoveries for the creditor. Privately appointed receivers usually have broad powers, including the power to carry on the business and to sell the debtor's assets by auction, tender or private sale.

Although private appointments can reduce costs and delays and provide the secured creditor with greater control over the realization process, it is often advisable to obtain a court appointment. This is especially the case where there are major disputes among creditors or with the debtor, or in any case where it is clear that the assistance of the court will be required throughout the receivership. It is also often important to potential purchasers of the assets of insolvent businesses to have the ability to obtain court approval of asset sales.

b. Court Appointment of a Receiver

The jurisdiction for a court appointment of a receiver is found in the provincial rules of court and in Section 243 of the BIA (National Receiver). A receiver can be appointed under the rules of court alone, but it is more common for the appointment to be made under both the BIA and the rules of court.

Court appointment of a receiver typically begins with a secured creditor commencing an action or application against the debtor. The receiver is then appointed in a summary proceeding within the action or application. The order appointing the receiver normally stays proceedings against the receiver, provides the receiver with control over the assets of the debtor, authorizes the receiver to carry on the debtor's business to borrow money on the security of the assets and, ultimately, authorizes the receiver to sell the debtor's assets with the approval of the court. If necessary, the court order

may authorize the receiver to commence and defend litigation in the debtor's name.

Whereas the duty of a privately appointed receiver is primarily to the secured creditor who appointed it (subject to a general duty to act in a commercially reasonable manner), the court-appointed receiver is an officer of the court and has the duty to protect the interests of all creditors of the debtor corporation. By the nature of its appointment, a court-appointed receiver may not be entitled to seek indemnities from those who sought the appointment. In practice, secured creditors do, in some cases, provide indemnities.

A court appointment may be necessary if the debtor opposes the appointment of a receiver and will not let the receiver into possession. In some provincial jurisdictions, the courts will grant possession orders and affirm the appointment of a private receiver with powers as set out in the security documents, thereby avoiding a court appointment. Other circumstances exist where a court appointment may be preferable. For example, in large, complex matters where the assets and operations of the debtor are located in a number of jurisdictions and security interests are in competition, it is generally in the interest of all concerned to arrange for appropriate management and realization of the assets, pending an ultimate determination by the court of the rights of the various secured creditors.

4. Bankruptcy

The administration of bankruptcy is carried out by trustees in bankruptcy who are licensed and supervised by the federal government. When a debtor becomes bankrupt, a trustee is appointed and all of the bankrupt's assets are vested in the trustee. Claims of creditors, other than secured creditors, are stayed. The trustee has a duty to review the validity of all security over the bankrupt's assets and to apply to the court to set aside security that is not valid. Subject to confirmation of the validity of its security and a very limited stay provision, a secured creditor is entitled to take possession

and dispose of all collateral over which it holds security, notwithstanding the occurrence of a bankruptcy.

A bankruptcy may occur in one of several ways:

- The debtor makes a voluntary assignment into bankruptcy;
- The court grants a bankruptcy order on the application of one or more creditors;
- Unsecured creditors or the court refuses to approve a restructuring proposal under Part III of the BIA; or
- The proposal is subsequently annulled by the court.

In most cases, creditors elect a board of inspectors to guide the general conduct of the bankruptcy proceedings. The trustee requires consent of a majority of the inspectors to sell assets, carry on the business of the bankrupt, commence or continue legal proceedings or to compromise any claims made by or against the bankrupt estate.

The major classes of creditors in a bankruptcy are: secured creditors, preferred creditors and unsecured (ordinary) creditors. A secured creditor may be represented by an agent or a receiver for the purpose of realizing assets subject to its security.

a. Priorities in a BIA Liquidation

Preferred creditors have priority over unsecured creditors and are able to include in their claims the costs of administration of the bankruptcy, the fees of the trustee, employees' claims, municipal taxes and claims of a landlord. Claims by the Crown are not preferred claims and, with a few significant exceptions, are mostly unsecured. Unsecured creditors are entitled to share *pro rata* in the realization of the bankrupt's assets after payment of preferred creditors and are subject to the claims of secured creditors.

Recent amendments to the BIA and CCAA allowing DIP financing have created a "super priority charge" for lenders that provide interim financing to debtor

companies. Such financing is permitted only by court order and requires that existing secured creditors are provided notice. Such a super priority will survive in a bankruptcy if a debtor-in-possession restructuring has failed.

The federal and provincial governments have been striving to create a statutory deemed trust or lien against assets in priority to contractual types of security. The objective is to ensure preferential treatment of debts due to the federal and provincial governments and to employees for certain liabilities. These efforts have been met with limited success. Many of the claims involved are not effective in a bankruptcy. However, there are new super priority claims created in the BIA and CCAA for wages and pension arrears and a new federal government plan (the Wage Earner Protection Program, or “WEPP”) to provide for the payment of wage arrears in an insolvency.

b. Avoidance Transactions

Under the BIA and certain provincial statutes, the trustee may impugn or set aside certain transactions or payments entered into or made by the bankrupt. These are generally fraudulent preferences, fraudulent conveyances and transfers under value. There are limitation periods that apply in each case and different rules and onuses of proof depending upon whether a transaction/payment was at arm’s length. In practice, Canadians are not as aggressive as their American counterparts in bringing these proceedings.

c. Interim Receiver

An interim receiver is appointed to preserve and protect an estate pending the outcome of insolvency proceedings. Under the BIA, an interim receiver may be appointed by the court in three instances:

- i. On or after the filing of an application for a bankruptcy order;
- ii. On the filing of a notice of intention to file or the filing of a proposal under Part III of the BIA;
- iii. When an enforcement notice is about to be sent or has been sent by a secured creditor indicating its intention to enforce its security.

In all cases, the appointment is of short duration, and the court specifically sets out the powers of the interim receiver. The interim receiver is usually instructed to take possession of the assets and control the receipts and disbursements of the debtor, but not otherwise interfere with the day-to-day business. The interim receiver is the watchdog of the assets during the hiatus between the filing of the application and its hearing, or during the time prior to the appointment of a receiver or the approval of a proposal.

Prior to the most recent amendments to the BIA in 2009, interim receivers were often appointed with a mandate similar to that of a receiver. However, recent amendments to the BIA ensure that the interim receiver carries out a truly “interim” role.

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