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Global Restructuring & Insolvency Guide

Canada

Overview and Introduction

This chapter discusses the various types of bankruptcy, insolvency and restructuring proceedings applicable in Canada.

Legislative authority in Canada is divided between the federal and provincial governments by subject matter. Constitutionally, bankruptcy and insolvency is a federal responsibility while property and civil rights fall within provincial jurisdiction. Labour and pension law, as well as contracts that create security interests or property rights, are mainly governed by provincial legislation, but the federal government has jurisdiction over those areas in certain industries deemed national in scope. Consequently, there is an application of both federal and provincial statutes in insolvency proceedings.

The insolvency regime is primarily governed by two federal statutes that apply across Canada: the Bankruptcy and Insolvency Act (the “**BIA**”) and the Companies’ Creditors Arrangement Act (the “**CCAA**”). In the event of a conflict with provincial legislation, under a legal principal known as paramountcy, the provisions of the BIA or CCAA will prevail. The Winding-Up and Restructuring Act, another restructuring statute, deals primarily, but not exclusively, with financial institutions such as banks, trust or insurance companies that are in financial distress. Most reorganisations in Canada are conducted under the BIA or CCAA and this Guide will focus on those statutes. Typically, the BIA is used for less complicated restructurings or straightforward liquidations of assets. The CCAA is used for more complex restructurings and those requiring more time to be completed. In addition, the recently enacted Wage Earner Protection Program Act (the “**WEPPA**”) deals with certain employee wage priorities in the context of a bankruptcy or receivership.

The BIA applies to a broad range of entities including individuals, corporations, cooperatives, partnerships, income trusts, and estates of deceased individuals. The CCAA applies to companies incorporated under federal or provincial law, or incorporated outside Canada but doing business or with assets in Canada, and income trusts. This guide will use the terms “individual” and “company” when discussing who may make use of the BIA and CCAA.

The BIA represents the most complete code, providing substantive provisions dealing with, *inter alia*, the scope and breadth of stays of proceedings, distributional priorities, fraudulent transfers, the sale of assets, the treatment of contracts, interim financings, cross-border proceedings and penalties and sanctions against debtors and their directors for violations under the BIA. The BIA also contains provisions dealing with the appointment of receivers and the rules regarding their conduct. The CCAA is a more flexible statute than the BIA, as it is designed to allow courts more discretion in assisting restructuring corporations. Like the BIA, the CCAA also has substantive provisions dealing with the scope and breadth of stays of proceedings, distributional priorities, fraudulent transfers, sales of assets, the treatment of contracts, interim financings, and cross-border proceedings.

In 1992 and 1997, major reforms to the insolvency regime in Canada placed increased emphasis on encouraging restructuring rather than bankruptcy. The past decade has seen further review of the insolvency and restructuring laws in Canada in an effort to determine whether such laws were meeting their objectives. The culmination of this review was a number of significant reforms which came into force on 7 July 2008 and 18 September 2009. Overall, the recent reforms reflect a codification of existing practices, but there are also significant new protections for workers and pensioners affected by corporate insolvencies.

Corporate Legislation

Each of the federal government and the 10 provinces has its own legislation creating and regulating corporations. For example, the Canada Business Corporations Act (the "**CBCA**") is the federal act respecting Canadian business corporations, whereas in Ontario, the provincial act for business corporations is the Business Corporations Act (the "**OBCA**").

These statutes contain provisions to establish and govern corporations created thereunder, while also imposing certain restrictions on actions that corporations can take while insolvent as well as actions (such as issuing dividends) that would render the corporation insolvent.

Both provincial and federal legislation also impose liabilities on officers and directors of a corporation for their actions or omissions in contravention of the statutes and their provisions.

Judicial and Regulatory Framework

Unlike in some jurisdictions, including the US, there is no separate bankruptcy court in Canada. Rather, the provincial Superior Court(s) of each province are vested with bankruptcy and insolvency jurisdiction by virtue of the federal statutes.

The Supreme Court of Canada is the final court of appeal in Canada and hears appeals from all provincial courts of appeal and the federal Court of Appeal. Parties seeking to appeal to the Supreme Court of Canada in most circumstances must seek leave to do so, as there is no automatic right of appeal with respect to matters involving bankruptcy, insolvencies and property rights.

The Office of the Superintendent of Bankruptcy ("**Superintendent**"), which forms part of the federal Ministry of Industry and Trade, has a general supervisory function over all bankruptcies and all matters to which the BIA applies. The other administrative official is the official receiver: employees of the Superintendent appointed across Canada to deal with the administrative obligations specified by the BIA, such as accepting the documents that are filed in connection with bankruptcy or proposal proceedings as well as monitoring proceedings to determine whether any offences under the BIA have been committed by a bankrupt.

Trustee in Bankruptcy

The Superintendent licences and regulates those persons, primarily accountants, who have undergone specialised training to become a trustee in bankruptcy (the "**trustee**"). The formal role of accountants is a legacy of the UK tradition which underpins Canadian law and is an important point of difference between US and Canadian insolvency practice. The trustee is the main actor in the Canadian insolvency system and is charged with administering bankruptcies and monitoring insolvency proposals and CCAA restructuring proceedings.

Types of Insolvency Administrations

The typical personal insolvency options are:

1. Bankruptcy, which entails a liquidation and distribution of assets followed by a discharge from debts at the time of the bankruptcy;

2. Proposal to creditors for a binding compromise of debts at the time the proposal is made; or

3. Consumer proposal for a fast-track binding compromise of debts for individuals with lower debt levels.

For an insolvent company, there are more insolvency options available:

(i) Bankruptcy with the liquidation and distribution of assets, but without any discharge from debts;

(ii) Proposal to creditors;

(iii) Liquidation or restructuring under the CCAA; or

(iv) Court or private receivership proceedings for liquidation and distribution of assets.

These different insolvency proceedings may take place at the same time or run consecutively. For instance, an unsuccessful proposal will result in an automatic deemed bankruptcy of the corporation or individual. It is also common for a receiver to be appointed during or following a proposal, bankruptcy or CCAA proceeding in order to carry out certain goals for secured creditors, such as interim asset preservation or marketing and sale of assets.

Definition of Insolvent Person

An insolvent person, as defined under the BIA, is any individual or company that resides, or has property or business, in Canada, has liabilities to creditors exceeding CAD 1,000, and:

(i) For any reason is unable to meet its obligations as they generally become due;

(ii) Has ceased paying current obligations in the ordinary course of business as they generally become due; or

(iii) Whose aggregate property is not, at a fair valuation, sufficient, or – if disposed of at a fairly conducted sale under legal process – would not be sufficient to enable payment of all obligations, due and accruing due.

"Person" has an expansive definition and is defined in the BIA as meaning an individual or natural person, a partnership, an unincorporated association, a corporation (which includes income trusts), a cooperative society or an organisation; the successors of a partnership, association, corporation, society or organisation; and the heirs, executors, liquidators of the succession, administrators or other legal representatives of a person, according to the law of that part of Canada to which the context extends.

The CCAA does not define "insolvency," and the term has been given a broader meaning than set out in the BIA to include, for example, a corporation not insolvent but on "the eve of insolvency", to enable greater restructuring opportunities under the CCAA.

Meaning of Bankrupt

To be bankrupt in Canada denotes a legal state wherein a debtor has lost the debtor's title, equity and rights in and to the debtor's assets in favour of a trustee that is appointed and in whom the title to, and equity and rights in connection with the assets of the debtor-bankrupt, are vested.

The BIA sets out that only a "debtor" that is an insolvent person may become bankrupt.

The Bankruptcy and Insolvency Act ("BIA")

The purpose of the bankruptcy regime is to allow the bankrupt entity protection from creditors and provide for the orderly and fair liquidation and distribution of the bankrupt's assets to creditors.

Upon bankruptcy, a trustee becomes vested (whereby ownership is transferred by operation of law) with all of the bankrupt's property that is subject to the bankruptcy. The trustee's rights in the property are subject to the interests of third parties including secured creditors (which generally include lessors under perfected finance leases) and property owners (which generally include lessors under true rental leases). Although the trustee's rights are subject to those of secured creditors and property owners, and even though secured creditors and property owners are not typically stayed by a bankruptcy, the trustee can require any party claiming rights in an asset in the possession of the trustee to prove its claim in accordance with specified BIA procedures. Until those procedures are exhausted or the trustee consents, the trustee is entitled to remain in possession of the property in issue.

The trustee's primary duties are to collect, preserve and sell the assets of the bankrupt, and to distribute available proceeds to creditors in accordance with their prescribed priorities and *pro rata* within each class of creditors. The trustee must also investigate the affairs of the bankrupt and transactions entered into prior to bankruptcy.

The BIA provides a broad stay of proceedings which applies to all creditors, aside from secured creditors exercising rights to enforce against their security. In certain circumstances, the stay of proceedings may be lifted to permit actions by creditors to proceed. This chiefly happens in situations where there are allegations which, if proven, would survive bankruptcy, such as the bankrupt obtaining property by false pretences, by fraudulent misrepresentation or by fraud while acting in a fiduciary capacity. In limited circumstances, the stay of proceedings may be extended to a secured creditor realising its security where the trustee seeks an alternative method of liquidation that would yield recovery for unsecured creditors after the secured creditor is paid in full.

The procedures involved in a corporate bankruptcy are similar to those for individuals. Bankruptcy can occur voluntarily as a result of an insolvent debtor filing an assignment in bankruptcy, or involuntarily as a result of a creditor filing a bankruptcy application in respect of an insolvent debtor.

Voluntary Bankruptcy

The most common way for an individual or company to become bankrupt is by making a voluntary assignment into bankruptcy. A voluntary assignment requires an application to the official receiver on a prescribed form which nominates a trustee to administer and distribute the assets of the bankrupt to creditors. Bankruptcy comes into effect on the date of acceptance by the official receiver. No application needs to be made to a court.

Involuntary Bankruptcy

Bankruptcy may be initiated involuntarily through court action by a creditor or creditors whose claim exceeds CAD 1,000 and where an act of bankruptcy has been committed. An application for a bankruptcy order must set out the debt owed by the debtor, the proposed trustee, and the act of bankruptcy that the creditor believes has been committed. The typical act of bankruptcy alleged is generally failing to pay debts when they are due, but it can also include the giving of preferences to other creditors and fraud. The bankruptcy application can be disputed, in which case an expedited trial of the issues is set to decide whether an act of bankruptcy has been committed.

Discharge from Bankruptcy

An individual first-time bankrupt who is not classified as a tax debtor will, provided he attends mandatory debt counselling, receive a discharge nine months after the date of bankruptcy unless: (i) an opposition to the discharge is filed; or (ii) the bankrupt has surplus income, in which case, he will receive an automatic discharge after 21 months. An individual with a personal tax debt in excess of CAD 200,000 that represents more than 75% of total creditor claims will be classified as a tax debtor and not be eligible for an automatic discharge. An individual bankrupt who is not entitled to an automatic discharge must make an application to court. A court hearing (usually before a subordinate judicial officer known as a bankruptcy registrar) will be held to determine the terms of the bankrupt's discharge or whether the discharge should be refused because of conduct by the bankrupt. Typically, either financial or conduct conditions will be imposed on the bankrupt. A discharge is normally refused only in cases of serious misconduct by the bankrupt, such as hiding assets or subverting the rights of creditors. A discharge operates to release the individual from all debts that were provable in bankruptcy except secured debts and debts that survive bankruptcy.

A corporate bankrupt cannot receive a discharge from bankruptcy unless it pays all of its debts in full or makes a successful proposal to its creditors.

Discharge of the Trustee

The trustee can apply for discharge, once he has realised on all the realisable property of the bankrupt and otherwise completed the administration of the bankruptcy and the trustee's duties under the BIA. If there are any remaining unrealisable assets of the estate, the trustee may obtain the approval of the inspectors who are elected by the creditors (see below) to return the assets to the bankrupt or may dispose of the assets in another manner by way of a court order. When the trustee is discharged, he has no further duties under the BIA and receives a discharge against any liabilities for his conduct other than fraud.

Proposals to Creditors

A proposal is a relatively flexible method available to an individual or company to restructure financial obligations rather than simply filing for bankruptcy. Once approved by the requisite majority of creditors and then by the court, the proposal becomes a contract binding both the debtor and all creditors whether they voted in its favour or not.

With the assistance of a trustee, an insolvent company can initiate a BIA proposal restructuring by filing with the official receiver either a notice of intention to make a proposal ("**NOI**") – a form indicating that the company intends to make a proposal to creditors – or a proposal itself, i.e. a document detailing the proposed reorganisation plan. Generally, a NOI is filed first and then the proposal is finalised after negotiating with creditors over its terms.

The advantages for a company making a proposal for a corporate restructuring are that it: (i) has protection from its creditors (including secured creditors) through a stay of proceedings; (ii) continues to operate its business; and (iii) remains in possession of its property. The initial stay is only 30 days, but where the restructuring company is able to satisfy the court that a restructuring is potentially viable, extensions of the stay for up to an additional five months are obtainable. In a restructuring under a proposal, a trustee assists with the preparation of the proposal and is required to report to creditors and the court on the viability of the proposal and the business of the restructuring company.

In order for the proposal to succeed, the restructuring company must gain the support of more than 50% in number of the voting creditors in each class of creditors, representing at least two-thirds in value of the claims in the class, as well as the approval of the court (which is usually granted if the proposal has been approved by creditors). There is an automatic deemed bankruptcy if the proposal fails to gain the approval of either the creditors or the court.

The more common types of proposals include a cash settlement proposal, which provides a pay-out of some amount on a *pro rata* basis to outstanding claims, either as a lump sum or over time; and a liquidation proposal, which provides for the orderly liquidation and sale of the assets of a business (often a new start-up entity) with the proceeds of sale then being shared amongst creditors.

If the proposal is approved, the company will enjoy its benefits so long as all its terms are implemented as promised. If the company defaults in its performance of the proposal terms, a bankruptcy can result.

Consumer Proposals

Consumer proposals were introduced into the BIA to allow individuals with relatively small amounts of unsecured debt to have access to an inexpensive and expedited procedure to make a proposal to their creditors. The debt limit for a consumer proposal is CAD 250,000 (excluding any mortgages on the individual's principal residence). The main difference from a regular proposal is that there is a deemed acceptance of the consumer proposal unless creditors representing 25% of the claims against the individual request a meeting of the creditors. There is an automatic deemed bankruptcy upon a default in the performance of an accepted consumer proposal.

Disclaimer and Resiliation of Contracts

The 2009 amendments to the BIA provide that a debtor may disclaim or resiliate (i.e., terminate) certain contracts to allow for a successful restructuring. The disclaimer or resiliation must enhance the prospect of a viable restructuring and not merely be convenient for the debtor to get rid of a contract.

Any contract may be disclaimed or resiliated, with the exception of:

(i) An eligible financial contract;

(ii) A collective agreement (i.e. a collective bargaining agreement);

(iii) A financing agreement if the debtor is a borrower; or

(iv) A lease where the debtor is the lessor.

The debtor must first obtain the approval of the trustee, and if the trustee approves, a notice of the disclaimer or resiliation is sent to the contract counterparty. The counterparty may seek to overturn the debtor's disclaimer or resiliation by appealing to the court within 15 days. Any loss suffered as a result of the disclaimer or resiliation becomes a provable claim in the proposal. Any executory contract that is not disclaimed or resiliated will remain in full force and effect during a NOI or proposal proceeding.

Assignment of Contracts

Under the BIA, a debtor in the midst of a NOI or proposal may seek a court order assigning to another party the debtor's rights and obligations under an agreement. Only business debtors or individuals who carry on business and seek assignment of a business agreement may seek such an order. Any business agreement is potentially assignable except an agreement entered into after the filing of a proposal or the NOI (whichever came first), an eligible financial contract, or a collective agreement. Moreover, the court may make such an order only if it is satisfied that all monetary defaults in relation to the agreement – other than those arising by reason only of the person's bankruptcy, insolvency or failure to perform non-monetary obligations – will be remedied on or before the date fixed by the court.

In deciding whether to make such an order, the court must consider:

(i) Whether the person to whom the rights and obligations are to be assigned is able to perform the obligations;

(ii) Whether it is appropriate to assign the rights and obligations to that person; and

(iii) Whether the proposal trustee approved the proposed assignment.

Sale or Disposition of Assets under the BIA

During a NOI or proposal proceeding, a debtor may remain in control of its assets and operations and can sell or dispose of assets in the ordinary course, or alternatively a trustee or receiver may be appointed. Sales or dispositions out of the ordinary course are prohibited unless the debtor complies with the recently enacted regime under the BIA.

Where a debtor wishes to dispose of business assets out of the ordinary course, court approval is required. Notice of the motion to approve the proposed sale or disposition motion must be given to any secured creditor likely to be affected by the proposed sale of disposition.

The court is to consider six factors when weighing whether to approve the proposed sale or disposition:

(i) Whether the process leading to the proposed sale or disposition was reasonable under the circumstances;

(ii) Whether the trustee approved the process leading to the proposed sale or disposition;

(iii) Whether the trustee filed a supportive report stating that in its opinion the proposed transaction would be more beneficial to creditors than a sale or disposition in a bankruptcy;

(iv) The extent to which creditors were consulted;

(v) The effects of the proposed transaction on creditors and other interested parties; and

(vi) Whether the consideration is fair and reasonable taking into account market values.

Where the proposed sale or disposition is to a related person, the court must, in addition to the above, also be satisfied that good faith efforts were made to sell to unrelated parties (i.e. there was a public sales process, etc.) and that the related person's offer is the best (or only) offer in the process leading to the proposed sale or disposition.

The BIA defines a "related person" as a director or officer of the debtor, a person that has direct or indirect *de jure* control of the debtor or any person related to such persons. To the extent that the court is inclined to approve the proposed transaction, the court may authorise the sale or disposition free and clear of any charge, lien or restriction, with the proceeds to stand in the place of the assets.

The Companies' Creditor Arrangement Act ("CCAA")

In comparison to the structured and statute-driven process under the BIA, the CCAA is a court-driven process that offers a flexible and powerful tool for restructuring or liquidating corporations in financial difficulty. Whilst not required, it is not unusual for a single judge to supervise a CCAA case from beginning to end. The considerable judicial involvement and discretion under the CCAA leads to a more expensive process than under the BIA.

The CCAA has been referred to as the Canadian chapter 11, referring to US Bankruptcy Code chapter 11 proceedings, but there are important differences. For instance, CCAA protection is not automatic and there is no ability to "cram down" classes of creditors by seeking court authorisation. The absolute priority rule and equitable subordination do not exist in Canada.

The CCAA is intended for use by large corporations, but in fact the threshold requirement to initiate a CCAA reorganisation is merely that the corporation, either alone or with its affiliates, has at least CAD 5,000,000 of debt, and that each applicant is insolvent. The real bar to accessing the system for small companies is the extra cost of the court-supervised system under the CCAA.

Initial Application

CCAA proceedings are commenced by a court application by the insolvent company, but protection is not automatically granted. If the court is satisfied that the insolvent company has a reasonable prospect of restructuring, its initial order will grant the insolvent company a stay of proceedings of up to 30 days that provides comprehensive protection from creditors. Typically, the stay of proceedings is extended upon further applications by the insolvent company, often resulting in a stay period spanning many months or, in some cases, several years. There is no fixed limit on the extension of the stay of proceedings, so long as the extension is not prejudicial to the creditors as a whole and a viable process is underway.

During the stay of proceedings, the debtor company normally continues operations while it attempts to restructure. However, it is increasingly common for the senior lenders or interim financiers to require that an agreed chief restructuring officer be appointed to direct the restructuring process, since it is unusual for existing management to have the specialised expertise needed to guide a company through a successful restructuring process.

Appointment of Monitor

A key provision of the CCAA is the appointment by the court of an independent party to monitor and supervise the restructuring. The monitor is a licensed trustee whose main function is to report to the court and creditors on the business and financial status of insolvent company and to assist the insolvent company in developing a restructuring plan. Once appointed, the monitor becomes an officer of the court.

In order to fulfil its monitoring and review duties, the monitor has a right of access to the debtor's property and books and records.

Critical Suppliers

Under the CCAA, the court may designate a critical supplier where it is satisfied that the goods or services that are supplied are critical for a viable restructuring. The critical supplier is ordered to continue to supply on terms that are consistent with the supply relationship and is granted a priority court charge over the assets and property of the debtor for the value of goods or services supplied. This is a new provision to the CCAA and not comparable to the chapter 11-style critical supplier designation where suppliers are routinely paid their pre-filing claims as a condition of post-filing supply. However, the new provision leaves open the possibility of the court ordering the payment of pre-filing debts as part of the terms of continued supply, and payment has been ordered in a very limited number of cases.

Plan of Compromise or Arrangement

The proposal that the insolvent company puts to its creditors (and sometimes shareholders) for a vote is called the plan of compromise or arrangement. There are no restrictions on what terms a plan of compromise or arrangement may include. Frequently, there is an offer to pay a fixed amount divisible amongst creditors, either as a lump sum or over time. A conversion of debt to shares is also not uncommon. The plan requires approval by a double majority (majority of creditors in the class and two-thirds of the creditors in value within that class). Creditor classes are not defined in the CCAA, but are formulated by the insolvent company and usually set out in the proposed plan of arrangement. A “commonality of interest” test is frequently used to group creditors into classes of similarly situated claims, and creditors can ask the court to revise creditor classifications if the classes are being used by the insolvent company to illegitimately swamp a dissenting group with unique rights.

Once the plan has been voted on and accepted by the creditors, the court holds a sanction hearing at which time the court reviews the fairness of the process and the plan. If there is sizable creditor support, the approval of the court is almost always given.

If a class of creditors or the court does not approve the plan, the insolvent company does not automatically go into bankruptcy. Unlike in the US, there is no right to cram down dissenting classes. It is possible for the insolvent company to submit a new or amended plan. However, in the event of non-approval, it is common that the senior secured creditor or unsecured creditors will immediately seek to lift the stay of proceedings to exercise their available remedies against the insolvent company. This typically results in the insolvent company being placed into bankruptcy or receivership or both.

Restructuring Powers

The CCAA authorises the court to: (i) approve secured debtor-in-possession (“**DIP**”) financing and grant a priming charge for the DIP lender, as described below; (ii) grant priority charges for professional fees related to the restructuring process; and (iii) indemnify directors and officers against post-filing liabilities to induce them to remain in office.

Disclaiming Agreements

The restructuring powers available under the CCAA include the ability of the court to order an assignment of an agreement between a third party and the insolvent company and the ability of the insolvent company to disclaim agreements with a third party if the consent of the monitor or court approval is obtained. Unlike a chapter 11 DIP in the United States, an insolvent company in Canada cannot disclaim a collective agreement under the CCAA. As under the BIA, there are other specified types of contracts that cannot be disclaimed under the CCAA.

Asset Sale

Another significant restructuring power is the ability to conduct asset sales outside of the ordinary course of business and outside the filing of a plan of arrangement. Before an asset sale will be approved, the court must be satisfied that statutorily required payments for unpaid wages and pension plan contributions will be made.

The court will consider six factors when weighing whether to approve the proposed sale or disposition of assets:

(i) Whether the process leading to the proposed sale or disposition was reasonable under the circumstances;

(ii) Whether the monitor approved the process leading to the proposed sale or disposition;

(iii) Whether the monitor filed a supportive report stating that in its opinion the proposed transaction would be more beneficial to creditors than a sale or disposition in a bankruptcy;

(iv) The extent to which creditors were consulted;

(v) The effects of the proposed transaction on creditors and other interested parties; and

(vi) Whether the consideration is fair and reasonable taking into account market values.

Assets sales to related parties are also subject to heightened scrutiny as to whether the value received is greater than what would have been received under a sale to a non-related party. The court may also authorise the sale or disposition to be free and clear of any charge, lien or restriction, with the proceeds to stand in the place of the assets.

Interim Financing

The CCAA allows for DIP financing for a debtor in a CCAA proceeding. The interim financing may be secured by a court order against the assets of the debtor and may rank ahead of claims of all other secured creditors (except those created by a previous court order that refused to consent to a subordination) of the debtor. Any such application must be on notice to any secured creditor that will likely be affected by any priority security or charge.

In deciding whether to make the order, the court must consider:

(i) The period during which the debtor is expected to be subject to proceedings under the CCAA;

(ii) How the debtor's business and financial affairs are managed during the proceeding;

(iii) Whether the debtor's management has the confidence of its major creditors;

(iv) Whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the debtor;

(v) The nature and value of the debtor's property;

(vi) Whether any creditor would be materially prejudiced as a result of the security or charge; and

(vii) The monitor's report referred to in paragraph 23(1)(b) of the CCAA, if any.

The CCAA leaves it open to the courts to determine the scope of the priority and quantum of any interim DIP financing and charge.

CCAA Liquidations

The CCAA was originally intended to allow large and complex insolvent company restructurings to take place. However, jurisprudence has developed whereby the CCAA is also used as a tool to liquidate. Sometimes the liquidation leads to a plan of arrangement which provides for the distribution of the proceeds.

However, if priorities are not contested and there is not enough to pay secured creditors in full then the court may simply authorise the termination of the proceedings once the liquidation is complete and authorise distribution to the secured creditors and other priority claimants.

Receiverships

Receivership is a remedy for the enforcement of a secured creditor's rights in which the receiver is empowered to take possession, manage on an interim basis, and then sell the insolvent company's property. It is possible to seek the appointment of a receiver over an individual but this is rarely done. Receiverships are common in Canadian corporate insolvencies and usually involve the liquidation of property or the sale of the insolvent company's business as a going concern.

Where a secured creditor intends to enforce against all or substantially all of an insolvent company's property, the BIA requires that the creditor gives a formal notice of the intention to enforce its security. This requirement imposes a 10-day waiting period on the appointment of a receiver after a secured creditor gives notice of a default entitling it to enforce its security (however, some factors under the common law may lengthen this waiting period). The purpose of this waiting period is to permit the insolvent company to either pay out to the creditor, or file for a formal restructuring under the BIA or CCAA. If the 10-day period elapses without a pay-out or the filing of a BIA restructuring, the secured creditor will not be subject to a stay if such a restructuring is later filed (the insolvent company may still, however, be able to attempt to file a CCAA application).

Receiverships can either be private, through the appointment by a secured party over the property of the insolvent company in which it has a secured interest, or court-ordered under either provincial or federal law, upon an application to the court (usually by a secured creditor). Since a bankruptcy does not generally affect the rights of secured creditors, a receivership can occur at the same time as a bankruptcy. Private receivers derive their authority from the secured creditor's security documentation. These appointments are generally less common than court-appointed receiverships, but are less costly and still employed when in conjunction with bankruptcies.

The BIA provides for two types of receiverships. The first is an interim receiver, whose appointment is intended to be of limited duration and scope. The second is a national receiver, who can be empowered to take possession and control of all or substantially all of the property of an insolvent debtor across Canada. The national receiver is a recent addition to the BIA and is intended to carry out the functions performed by a receiver appointed under provincial statutes. Creditors may still resort to provincial appointments, but an appointment under the BIA affords a significant advantage in the enforceability of the receiver's powers across Canada.

Informal Arrangements – Consensual Agreements

Frequently, before resorting to formal insolvency proceedings, an insolvent company will try to enter into contractual compromise or standstill arrangements with its creditors, usually involving debt repayment or deferral. The advantages of a reaching a consensual agreement with creditors include avoiding the stigma and asset-value erosion of formal insolvency proceedings and the risk of losing all assets or having an ongoing business shut down. However, it is often unrealistic to expect that a complex restructuring with divergent interests can be resolved on a consensual basis.

Informal Arrangements – "Look-see" Appointments

Before restructurings commence, a secured creditor may also, under the terms of its security agreement, appoint an informal monitor, typically a trustee. The purpose of the appointment is for the secured creditor to assess the viability of a restructuring through a neutral and professional assessment of the debtor's financial difficulties. Recommendations made are not binding on a debtor, but are usually followed so as to avoid losing the support of the secured creditor.

Other Specific Issues

Priority of Claims

Within each class of creditors in a bankruptcy or insolvency, the general rule is that their debts are ranked equally, and if the property of the bankrupt is insufficient to meet them in full, they will be paid *pro rata*.

The exceptions to the general rule are significant. Both federal and provincial statutes create super-priority statutory deemed trusts and liens relating to employee-related remittances for income taxes, employment insurance and the federal Canadian Pension Plan or provincial equivalents. Subject to statutory super-priority claims, secured creditors are entitled to deal with the collateral of the debtor secured to them. Property that is exempt from seizure in the province in which the property is located and within which the bankrupt resides does not become part of the bankruptcy.

BIA Section 38 Proceedings

Section 38 of the BIA provides a powerful tool for creditors of a bankrupt to acquire and pursue a right or chose in action to recover assets or value owing to an estate, where a trustee refuses or neglects to act.

Where the trustee chooses not to act to pursue a right to recover an asset of the estate, often where the costs to recover the asset are prohibitive, the creditor may apply to the court under section 38 of the BIA to be able to take an assignment of that right and pursue it for the creditor's direct benefit.

Super-priority for Unpaid Wage and Pension Claims

The BIA and CCAA provide that the court may approve a reorganisation or grant authorisation for interim asset sales only if it is satisfied that the restructuring company can and will make the payments that are statutorily required for unpaid wages as well as for unpaid pension plan contributions.

WEPPA now also gives certain employees' wage claims (such as for wages, vacation pay, and severance and termination pay), in the context of a bankruptcy or receivership, up to a certain amount, a higher priority than secured creditor claims.

Equity Claims

Claims arising from the purchase or sale of equity of an insolvent company are subordinated to all other claims. No proposal or plan of arrangement that provides for payment of an equity claim may be approved by the court unless all other claims are to be paid in full.

Notwithstanding the general prohibition, shareholders have some prospects for recovery by taking advantage of the ability to preserve and sell tax losses in restructured companies.

Transfers at Undervalue, Preferences and Fraudulent Conveyances

The BIA and CCAA both provide mechanisms for scrutinising transfers where the consideration received by the debtor is "conspicuously less" than the fair market value. There are broad powers with respect to transfers to non-arm's-length parties. There is also provincial legislation on this topic which is applicable in all insolvency scenarios.

Each of the aforementioned statutes operates in its own way with its own terminology, but all can be used in some circumstances to attack transactions, including the granting of security, which have the effect of preferring one creditor or party over other stakeholders. Most of the statutes only apply where the transaction in question occurs when the debtor is insolvent or on the eve of insolvency. Some of the statutes only apply only where the primary intention behind the transaction is to prefer the creditor (as opposed to obtaining financing, purchasing assets, etc.). The intent requirement significantly limits their applicability in practice. Further, the exchange of fair market value consideration (in this case, financing to acquire an asset) in a good-faith transaction is generally a complete defence to an attack. In essence, these statutes are primarily focused on unwinding strategies to diminish the estate, usually involving insiders, and not on arm's-length transactions or good-faith financing. Nevertheless, it is always wise to evaluate any proposed transaction against the tests in these statutes at the time of entering into them.

Rights of Reclamation of Property

The BIA allows creditors under certain circumstances to recover goods sold to a bankrupt within 30 days of the bankruptcy. Of considerable note is that a strict and timely process must be followed by a creditor who wishes to recover its goods, namely:

(i) A creditor must have sold goods, delivered same, and not been fully paid for those goods;

(ii) The creditor must present written demand, in the prescribed form, within 15 days of the purchaser becoming bankrupt or subject to a receivership;

(iii) The goods must have been delivered within 30 days of the bankruptcy; and

(iv) At the time of the demand, the goods must be in possession of the purchaser (or trustee or receiver), identifiable, in the same state as delivered, and have neither been sold by the purchaser nor become the subject of an arm's-length agreement of purchase and sale.

Rights of Set-Off

Under the BIA, the law of set-off applies to all claims against the bankrupt and to all actions instituted by the trustee for recovery of debts due to the bankrupt, in the same manner and to the same extent as if the bankrupt were either a plaintiff or defendant, as the case may be. The BIA permits a creditor, who is also a debtor to the bankrupt on another account, to claim the right of set-off against such amount.

The CCAA provides that the law of set-off applies to all claims made against the insolvent company and to all actions by the insolvent company to recover money.

Lifting the Stay of Proceedings

The BIA also affords a creditor the opportunity to apply to the court to seek to lift the stay of proceedings where the court is satisfied that the creditor is likely to be materially prejudiced if the stay is continued or there are other equitable grounds to do so.

"Materially prejudiced" generally involves situations where the creditor's claim is otherwise not dischargeable in bankruptcy or involves a situation where the bankrupt is a necessary party to adjudicate a matter that involves other parties.

Cross-Border Insolvencies

Canada adopted a modified version of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency in the 2009 amendments to the BIA and CCAA. Part XIII of the BIA and Part IV of the CCAA aim to provide mechanisms for dealing with cross-border insolvencies and to promote:

(i) Cooperation between the courts and other competent authorities in Canada with those of foreign jurisdictions in cases of cross-border insolvencies;

(ii) Greater legal certainty for trade and investment;

(iii) Fair and efficient administration of cross-border insolvencies that protects the interests of creditors, other interested persons and debtors;

(iv) The protection and the maximisation of the value of debtors' property; and

(v) The rescue of financially troubled businesses to protect investment and preserve employment.

Classification of a Foreign Proceeding

The starting point under both the BIA and CCAA is an application for recognition of a foreign proceeding by a foreign representative. The representative, who is appointed in the foreign proceeding, applies to the Canadian courts to have the foreign proceeding recognised under either Part XIII or Part IV.

The definition of "foreign representative" differs in the BIA and CCAA, with the CCAA definition being focused on monitoring for the purpose of reorganisation. Both definitions, however, contemplate the appointment in the foreign proceeding of a person as the foreign representative.

There is a subtle difference in the application of Part XIII of the BIA and Part IV of the CCAA, with the latter being aimed at foreign proceedings for the purpose of reorganisation only and the BIA being aimed at foreign proceedings for the purpose of either liquidation or reorganisation.

The BIA defines "foreign proceeding" as a judicial or an administrative proceeding, including an interim proceeding, in a jurisdiction outside Canada dealing with creditors' collective interests generally under any law relating to bankruptcy or insolvency in which a debtor's property and affairs are subject to control or supervision by a foreign court for the purpose of reorganisation or liquidation. This definition is broad enough to include liquidation proceedings, reorganisation proceedings and receiverships. The CCAA defines "foreign proceeding" more narrowly insofar as it is limited to proceedings that are for the purpose of reorganisation.

Under the BIA and the CCAA, the Court is required to make an order recognising the foreign proceeding if the foreign representative satisfies the Court that the proceeding is a foreign proceeding and that the applicant is the foreign representative appointed in that proceeding.

Further Classification of a Foreign Main Proceeding or Foreign Non-Main Proceeding

A foreign proceeding must be recognised as either a "foreign main proceeding" or a "foreign non-main proceeding". A foreign main proceeding is a proceeding that is commenced in the jurisdiction where the insolvent company has its centre of main interest (often referred to as "**COMI**") and a foreign non-main proceeding is a proceeding in any other jurisdiction. A foreign main proceeding will be afforded greater deference than a foreign non-main proceeding and have greater remedies available including automatic remedies upon recognition.

A foreign proceeding that is not a foreign main proceeding is a foreign non-main proceeding.

Recent Trends

Distressed Mergers & Acquisitions

The traditional debtor's reorganisation plan is often replaced by a management led pre-packaged sale of a financially distressed company as a going concern, the proceeds of which are then used to make a proposal to creditors.

Under a distressed scenario, a company typically commences efforts to sell the business. It then files for CCAA protection, after which management of the debtor company has the breathing space necessary to continue in its efforts to sell the company. The company is marketed as a going concern, as opposed to a liquidation, with job preservation being a fundamental driver and factor in the court approval process. Once a buyer is found, the court approves the sale transaction (without shareholder or bulk sales act approval) and issues a vesting order, vesting title in the assets to the buyer free and clear of all liens, security interests and encumbrances all of which are transferred to the proceeds of sale.

Recently, Canadian courts have adopted the US concept of "stalking horse" bid procedures to sell distressed businesses. Under this process, the distressed company engages in a sale process, selects a stalking horse bid and enters into an agreement of purchase and sale with the stalking horse bidder which is approved by the court. The court also approves an auction process to market test the initial bid. Subsequent bidders' offers are based on substantially similar terms as the stalking horse agreement of purchase and sale and the purchase price must be greater than the stalking horse purchase price by a defined amount. If another bid is accepted, then the stalking horse bidder receives a break fee and expense reimbursement for the lost deal.

Restructuring using the Canadian Corporate Statute

Recently, the Canada Business Corporations Act ("**CBCA**") has been used as an alternative to the CCAA, to implement certain types of restructurings. Although the CBCA is not fundamentally an insolvency statute, section 192 of the CBCA establishes a statutory procedure by which a company can seek court approval for an arrangement that effectively implements a restructuring.

The advantages of a CBCA restructuring process over a CCAA restructuring process are that it is generally cheaper, faster, does not involve all of the creditors (just debt and equity), and has less stigma associated with it. In addition, equity holders have a greater chance of preserving some value, versus in a CCAA restructuring where equity is at risk of being wiped out entirely. The major differences include that the CBCA is used to implement exclusively a financial restructuring.

Under section 192 of the CBCA, only those companies that satisfy the statutory three-part test (meet the statutory requirements, put forward the arrangement in good faith and that the arrangement is fair and reasonable) can obtain court approval for a plan of arrangement. Although section 192 states that a corporation must not be insolvent to avail itself to the provision, courts have permitted insolvent companies to participate in an arrangement where one or more parties applying for court approval were solvent, or alternatively, where the insolvent applicant would be solvent after completing the arrangement. Further, courts only approve a section 192 arrangement if it is fair and reasonable. This requires a determination of "whether the court may conclude that an intelligent and honest business person, as a member of the class concerned and acting in his own interest, might reasonably approve of the plan".

Pension Restructuring

Large pension plan solvency deficiencies have been prevalent in recent years as a result of declines in the market value of pension plan assets largely due to the persistently low interest rate environment. This placing of additional cash flow demands on companies already tight for cash has had the domino effect of pushing many companies into bankruptcy and insolvency proceedings.

In Canada, an employer generally has two types of pension plans, a defined benefit pension plan and a defined contribution pension plan. A defined benefit pension plan is one in which the pension payments that an employee will receive are based on a formula calculated by actuaries based on factors such as average salary and years of service. The idea is that an employee is guaranteed a defined amount upon retirement. A defined contribution plan, on the other hand, is one where an employer makes yearly contributions based on a fixed percentage of the employee's earnings. There is no guarantee or promise about what an employee will receive when they retire. The funds are invested by the employer and when the employee retires, he will receive an annual pension from the fund.

A term frequently coming up in recent Canadian insolvencies is "solvency deficiencies" and the need for companies to remit "special payments" in addition to "normal payments". A solvency deficiency exists only under defined benefit pension plans (defined contribution plans are not underfunded because once an employer makes normal contributions, the plan is fully funded) where the plan liabilities exceed the plan assets. Special payments are required to be made when a solvency deficiency is identified. These liabilities can be significant and often drive the need for a company to seek restructuring protection under the CCAA.

Through a CCAA filing, typically ongoing special payments and arrears are suspended. The company just makes normal payments. Often a filing enhances a company's ability to better negotiate with the unions, pension regulator and plan administrator for the restructuring of the pension plan.

Rise of Unions as Key Players

Unions, pension regulators and pension administrators have more recently become key players in CCAA restructurings as a result of the increase in restructurings involving pension related issues. These players are present throughout the entire process and often even before.

Environmental Claims

At the forefront of Canada's biggest CCAA filings in recent years has been the controversy over a company's responsibility for claims by government regulators for environmental clean-up. Government authorities are aggressively pursuing both the debtor company and its directors through the courts in an effort to prevent the debtor from passing on the cost of remediation to third party creditors in a CCAA proceedings. Recent cases have held that environmental orders issued by regulatory authorities that are found to be monetary in nature will be found to be provable claims and hence subject to the CCAA claims process and stayed and compromisable.

The recent cases illustrate that, subjecting environmental orders to the insolvency process does not extinguish the liability of a CCAA debtor, but protects the polluter pay principle, by ensuring that regulators are not given super priority that would effectively pass the cost of remediation on to third party creditors.

However, recently, the government authorities have used a combination of environmental tribunals and CCAA proceedings to target the directors who ultimately approved a CCAA filing without making prior arrangements to fund a previously identified contaminated site. Even though some of the directors in question were not directors when the contamination occurred, a lower court ultimately held a group of directors liable for remedial costs, and before the case could be heard on appeal, the directors reached a significant settlement agreement with the government.

As a result, these recent trend of cases serve as warning to debtor companies and the directors, particular, directors of insolvent or near-insolvent companies of the risk of personal liabilities where there are outstanding environmental obligations.

Additional Cross-Border Observations

Some of the features of the Canadian insolvency landscape that are worth noting include the following.

Pace of Proceedings

The pace of proceedings in Canada is generally quicker than in the United States. This speed of action tends to favour secured creditors and property owners by keeping restructuring processes short and by preventing assets from being trapped for extended periods of time inside insolvency estates.

Support of Major Financiers

It is much more difficult for a debtor to restructure without the support of its major financiers. There are many reasons for this, including an underlying finance-friendly culture and the legacy of the United Kingdom's commercial law and its tradition of protecting domestic banks.

No Creditors' Committees in Canada

Another difference between American and Canadian practice is that there are effectively no creditors' committees in Canada. In a bankruptcy, at the first meeting of creditors, a form of creditors' committee is elected (the "**inspectors**"). However, the inspectors have no right to funding from the estate, no standing in court as a committee, and no independent power to manage the estate or initiate litigation. They therefore tend to play a very limited role. In CCAA proceedings, there is judicial discretion to create and fund committees, but it is still an exceptional remedy, rather than the rule.

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