

Canada

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Canada is comprised of 10 provinces and three territories. The federal government has jurisdiction over bankruptcy and insolvency laws, while provincial governments have jurisdiction over property and civil rights. Accordingly, Canada's two primary insolvency statutes, the Bankruptcy and Insolvency Act (BIA) and the Companies' Creditors Arrangement Act (CCAA), are federal. The BIA addresses personal and corporate insolvency and incorporates both bankruptcy and restructuring provisions. The CCAA deals exclusively with insolvent corporations and has become the statute of choice for larger corporate restructurings.

Provincial legislation governs the relationships between creditors and debtors in respect of the property of the debtor. With the exception of Quebec (which is a civil code jurisdiction), all Canadian provinces are common law jurisdictions. Each common law province has enacted a personal property security act, which addresses the granting and priority of security over personal property and the rights and remedies of a secured creditor in the event of debtor default. The laws governing Quebec and the three Canadian territories are outside the scope of this chapter.

1. The legal framework and the effectiveness of court processes/legal remedies

1.1 Describe the nature and effectiveness of the following processes:

(a) Debt recovery remedies where the creditor has no security

Except in specific situations, an unsecured creditor attempting to recover its debt must commence legal proceedings and obtain judgment. Only after judgment is obtained may the unencumbered assets of the debtor company be seized and sold to satisfy the debt. This can be a slow and costly process.

(b) The enforcement of security

Security may be taken against either real property or personal property. In general, the interpretation and enforcement of security agreements are matters of provincial law. Real estate security, including priority rules and enforcement rights, is governed by provincial mortgage, title and lending statutes. In the common law provinces, security against personal property is governed by the applicable personal property security act.

A secured creditor intending to enforce its security on all or substantially all of the property of an insolvent company is required to send the company an appropriate notice of its intention to do so. It is restrained from enforcing its security for 10 days after sending the notice, unless the insolvent company consents to earlier enforcement. After the expiration of the notice period, there are a number of ways for secured creditors to enforce their security, including the following.

Self-help: Upon default under a security agreement, a secured creditor is entitled to take possession of and realise upon the collateral. Generally, it has the right either to sell the collateral to recover the indebtedness (ie, power of sale) or, if the company or others with an interest in the collateral do not object, to take title to the collateral in satisfaction of the debt (ie, foreclosure).

Appointment of receiver: Where provided for in the security documents, a secured creditor may have the right to appoint a private receiver or receiver and manager to take possession of and realise upon the collateral charged to the secured creditor.

Alternatively, a secured creditor may seek the appointment of a court-appointed interim receiver, receiver or receiver and manager to safeguard assets or to administer the enforcement and realisation process. This remedy is commonly utilised in complex enforcement matters or where the secured party wishes to obtain the customary protections provided by applicable court orders.

Liquidation: On bankruptcy, the BIA imposes a stay of proceedings against the company but the stay does not generally apply to secured creditors, which are free to exercise their rights outside the BIA.

(c) Corporate bankruptcy/liquidation processes

Assignment under the BIA: A company may commence voluntary bankruptcy proceedings under the BIA by filing an assignment for the benefit of its creditors. To do this, the company must be an 'insolvent person' as defined in the BIA. The company would retain the services of a trustee in bankruptcy prior to commencing bankruptcy proceedings and would assist the trustee in preparing a preliminary statement of affairs. The commencement of voluntary bankruptcy proceedings may be completed expeditiously as there are no burdensome substantive or procedural requirements.

Application for a bankruptcy order: One or more creditors may file an application for involuntary bankruptcy which, if granted, results in a bankruptcy order being made against a company. For this application to be granted, the applicant must establish that it is owed a debt of at least C\$1,000 and that the company has committed an act of bankruptcy (eg, ceasing to meet liabilities generally when they become due) within the six months

preceding the filing of the application. Obtaining a bankruptcy order takes longer than an assignment in bankruptcy, given that applicable notice periods must be observed and court proceedings must be commenced and completed (which, if defended by the company, requires a trial of the issue).

Court-appointed interim receiver, receiver or receiver and manager: A receiver or receiver and manager may be appointed either contractually pursuant to the terms of a security agreement or under provincial legislation, such as the Courts of Justice Act (Ontario), if the court believes it is "just and convenient" to do so. Its powers are derived by contract or court order, as the case may be, and are generally broad.

An interim receiver may be appointed by the court pursuant to the BIA. The circumstances giving rise to the appointment of an interim receiver under the BIA vary, but generally the court must be satisfied that there is a danger that assets may disappear or that the company will not be in a position to manage its affairs. Historically, the powers and role of an interim receiver were somewhat narrow; however, in practice its powers and role are now broad and typically non-distinguishable from the powers and role of a receiver or receiver and manager (including with respect to the conduct of an orderly liquidation of the assets and business of a company).

The CCAA: Although traditionally utilised to carry out corporate restructurings, Canadian courts also allow the CCAA to be utilised to carry out orderly liquidations consisting of the sale of all or parts of a company's property and business.

(d) Formal corporate rescue processes

The CCAA: The CCAA may be used to stay secured creditors, unsecured creditors and non-creditors while the company restructures its secured and unsecured debt. CCAA proceedings are commenced by an application brought by the company or, in exceptional circumstances, its creditors. In general, the application seeks a stay of all proceedings against the company and an order that it file a plan of compromise or arrangement within a certain timeframe. The CCAA applies if the debtor company:

- is a Canadian company and has assets in Canada or carries on business in Canada; and
- is insolvent and has outstanding indebtedness in excess of C\$5 million.

In CCAA proceedings the court must appoint a monitor to supervise and assist in the preparation of financial information regarding the company and the plan of arrangement. The monitor is typically a firm of licensed trustees in bankruptcy.

Proposals under the BIA: Commercial reorganisations under the BIA are implemented by proposals, which may be filed by an insolvent or bankrupt company and made to both secured and unsecured creditors. Upon initiation of the proposal process, a stay of proceedings is automatically imposed.

1.2 What are the formal processes to effect a liquidation of the company's assets?

See section 1.1(c) above.

1.3 What is the effect on debt collection and the enforcement of security of:

(a) An adjudication of corporate bankruptcy/liquidation?

Unsecured creditors are stayed from pursuing their individual actions against the bankrupt. The unencumbered assets of the bankrupt vest in the trustee who, after administering the estate, will distribute these assets first to preferred creditors in the order set out in the BIA and thereafter on a *pro rata* basis to unsecured creditors. The stay of proceedings imposed under the BIA upon the bankruptcy of a company does not generally apply to secured creditors, which are in a position to realise on their security.

(b) The commencement of a formal corporate rescue process?

Proposals under the BIA: A stay of proceedings takes effect upon the filing of a notice of intention or a proposal (collectively, a proposal) pursuant to the BIA. However, the stay will not apply to:

- secured creditors that took possession of secured assets before the company filed its proposal;
- secured creditors that gave notice of their intention to enforce security more than 10 days prior to the proposal; and
- secured creditors that are not included in, or have rejected, the company's proposal.

The CCAA: The CCAA permits the court to order a

stay of proceedings against secured and unsecured creditors, as well as third parties, to prevent them from terminating or otherwise exercising their rights under contracts with the company. The purpose of the stay is to maintain the status quo while the company restructures its business. The CCAA permits an initial stay to be granted for up to 30 days, after which extensions are granted at the discretion of the court on notice to interested parties.

(c) The initiation of an informal corporate rescue process?

Unless a forbearance or standstill agreement is reached that contractually restricts a creditor's rights, the creditor can exercise its rights during an informal restructuring. Although an informal rescue process is effective in some circumstances, often a company or creditor may be forced to use formal rescue processes in order to have the benefit of a stay of proceedings.

1.4 Are insolvency procedures started in another jurisdiction in respect of a corporation incorporated in your jurisdiction recognised? In particular, what would be the impact of US bankruptcy proceedings being commenced?

The BIA: The international provisions of the BIA permit a foreign representative, appointed in a foreign proceeding relating to bankruptcy or insolvency, to apply to have a foreign order recognised and to seek whatever other relief it deems appropriate. However, Canadian courts have the discretion whether to recognise foreign proceedings and to grant such an application. Further, the BIA provides that the courts are not prevented from applying legal or equitable rules governing the recognition of foreign insolvency orders and are not required to give effect to an order that would be contrary to Canadian law. A Canadian court would consider an application to recognise a foreign proceeding involving a corporation incorporated in Canada. However, in this situation, it is more common that full bankruptcy or insolvency proceedings would also be commenced in Canada.

The CCAA: The CCAA permits a foreign representative in a foreign proceeding to apply for relief to facilitate arrangements that will result in a coordination of proceedings with any foreign proceeding. As with the BIA, the CCAA provides that a Canadian court is not bound to recognise any

foreign orders. In addition, the CCAA provides that an ancillary proceeding can be commenced in Canada in order to facilitate a restructuring in another country. A Canadian court would consider an application to recognise a foreign proceeding involving a corporation incorporated in Canada. However, in this situation, it is more common that full insolvency proceedings would also be commenced in Canada.

1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential personal liability for continuing to trade? In practice, are any such provisions actually enforced?

Directors are subject to fiduciary duties to act honestly and in good faith with a view to the best interests of the corporation and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Directors are generally not fiduciaries of creditors; however, in light of certain statutory duties imposed on directors, they may be liable to creditors if they act carelessly or oppressively and such careless or oppressive conduct results in harm suffered by creditors.

Directors of a bankrupt company may be liable if they ought to have known that a transaction carried out by the company when it was insolvent, or which jeopardised the company's solvency, was likely to cause a loss to creditors. In addition, any officer or director of a corporation who directed, authorised or participated in the commission of offences set out in the BIA may be liable upon conviction to payment of a fine or imprisonment.

The current corporate governance landscape is such that the actions of directors and officers are subject to a high degree of scrutiny. Accordingly, in the future there may be an increase in the number of prosecutions against directors and officers for BIA offences.

2. What are the advantages and disadvantages of triggering a formal insolvency or corporate rescue procedure?

These will vary when examined from the viewpoints of the principal stakeholders, the company and its management, secured creditors, unsecured creditors and the board of directors.

Company and management: Formal proceedings carry the advantage of an immediate stay of

proceedings, allowing the company a period of time to continue operations while it seeks to reorganise. The stay provides stability and may also protect management from actions by creditors or other stakeholders. In regard to disadvantages, formal proceedings diminish management's control over the company and are often seen as reducing the company's going-concern value.

Secured creditors: Secured creditors often see the value of their security eroded by losses before the commencement of formal proceedings. The stay of proceedings may not entirely reverse these losses, but the proceedings may allow secured creditors a greater input into the manner in which their security is used in the company's operations. Secured creditors may also be able to use proceedings to advance new funds and in return bolster their existing security. However, they will be subject to the loss of going-concern value occasioned by formal proceedings.

Unsecured creditors: Unsecured creditors are most negatively affected by the stay of proceedings. The company's pre-filing accounts payable are often not paid at all or are significantly compromised. Unsecured creditors may benefit from future business if the company is successful in its restructuring or is sold as a going concern. The formal proceedings also allow the unsecured creditors to obtain information and have some input in the court proceedings, as well as ensuring a fair and transparent distribution of the proceeds of a company's estate.

Board of directors: The board will usually benefit from a stay in legal proceedings and will receive indemnity against future environmental, employee and other liabilities. Frequently, these indemnities will be supported by a charge over the company's assets. Restructuring plans and proposals may compromise claims against directors personally, as well as against the company. Set against these considerable advantages, the directors will lose some or, in the event of a receivership, all control over the company and their actions will be subject to increased scrutiny by the company's creditors and the court.

3. What are the practical options for out-of-court restructuring?

Out-of-court restructurings often take the form of a negotiated agreement between the company and its

secured creditors. In order for a restructuring to succeed, the company will have to deal not only with its secured creditors, but also with its unsecured creditors and suppliers, as the support of such parties will likely be required to enable the company to be viable on an ongoing basis.

4. What is the effect on the management of a company of:

4.1 An adjudication of corporate bankruptcy/liquidation?

Upon bankruptcy, a company has no ability to deal with its assets or operate its business as such assets are vested in the trustee. Where a receiver (either private or court-appointed) is appointed over all a company's assets, it will typically operate the company and have exclusive possession and control of its assets.

In realisations carried out under the CCAA, the company remains in possession and control of its assets, subject to the oversight of a court-appointed monitor. Management's discretion may be restricted contractually pursuant to debtor-in-possession (DIP) funding arrangements (often involving one or more principal secured creditors).

4.2 The commencement of a formal corporate rescue process?

Proposal under the BIA: Subject to a contrary court order, the company retains the ability to conduct its business since the court-appointed proposal trustee is neither vested with title to the assets nor in possession and control of the company's assets or business.

The CCAA: Subject to the terms of the initial order, the company retains control of its business and assets. However, a monitor is appointed by the court to oversee the restructuring and the company's discretion may be restricted contractually pursuant to DIP funding arrangements.

4.3 The initiation of an informal corporate rescue process?

Management retains control of the company during negotiations with creditors.

5. Parties in interest/key players

5.1 Who is responsible for the 'case management' control and administration of a corporate bankruptcy/liquidation, a formal rescue and an informal rescue?

(a) Corporate bankruptcy/liquidation

A corporate bankruptcy is administered by a licensed trustee in bankruptcy under the BIA. The trustee is nominated by the company (in the case of an assignment in bankruptcy) or by the applicant creditor (in the case of bankruptcy arising from a bankruptcy order). In either case, the trustee must be either confirmed or replaced by the creditors at a meeting of creditors held within 21 days of the commencement of the bankruptcy.

The trustee of a bankrupt estate is supervised by inspectors appointed by the creditors. The inspectors stand in a fiduciary relationship to the general body of creditors and must perform their duties impartially and in the interests of the creditors. The role of the inspectors includes providing instructions to the trustee on the steps to be taken in order to protect the estate and the creditors, and ensuring that the trustee acts in accordance with the provisions of the BIA. The trustee must obtain the consent of the majority of inspectors before undertaking certain actions.

Trustees are insolvency practitioners who typically have accounting backgrounds and are licensed by the superintendent of bankruptcy to accept trustee appointments under the BIA.

The BIA specifies that certain duties and responsibilities are to be carried out by the Official Receiver, which consists of federal government officials deemed to be officers of the court. Their duties include:

- receiving certain filings in bankruptcy and other insolvency proceedings;
- reporting bankruptcy offences;
- performing examinations of bankrupts; and
- chairing certain meetings of creditors.

A liquidation may also be carried out through various types of receivership. An interim receiver appointed by the court pursuant to the BIA must be a licensed trustee and a private or court-appointed receiver is also typically a licensed trustee.

(b) Formal rescue

Formal turnaround proceedings are carried out

under either the CCAA or the proposal provisions of the BIA. In both cases the company retains control of its business and operations and is responsible for the development of the restructuring plan or proposal.

The CCAA: A monitor – typically an accounting firm with specialist insolvency and restructuring expertise – is appointed in the initial order granted by the court on the commencement of proceedings. The monitor is an independent officer of the court whose duties typically include:

- monitoring the company's business and operations;
- reporting to the court on the progress of the restructuring; and
- assisting the company in the formulation of its restructuring plan.

Proposal under the BIA: A proposal trustee is appointed to:

- oversee the restructuring process;
- assist the company in the formulation of the proposal; and
- report to the creditors and the court on the fairness and reasonableness of the proposal.

A proposal trustee must be a licensed trustee in bankruptcy. Although proposal proceedings are ultimately carried out under the supervision of the court, the court will typically have substantially less involvement in a proposal proceeding under the BIA than it would in a proceeding under the CCAA.

(c) Informal rescue

The company is responsible for the case management and control of an informal restructuring. However, in most cases the company will be assisted by both legal and professional advisers.

5.2 Who is responsible for preparing the restructuring plan in a formal or informal rescue?

The company has the primary responsibility for the preparation of the restructuring plan or proposal in both formal and informal restructurings, typically assisted by its legal counsel and the monitor or proposal trustee.

In exceptional circumstances, creditors may be permitted to present a restructuring plan in a CCAA proceeding.

5.3 Who are the key players? What are their roles and responsibilities?

See section 5.1.

6. What financial information is available to creditors?

(a) Corporate bankruptcy

Creditors are provided with a statement of affairs providing details of the company's assets and liabilities, in addition to reports from the trustee on the causes of the insolvency, the progress of the bankruptcy and the realisation of assets and distribution of proceeds.

Formal restructuring: The creditors will have access to periodic reports of the monitor in a CCAA proceeding, or the proposal trustee in a proposal under the BIA, providing details of the progress of the restructuring and the business and financial affairs of the company. Initial CCAA application materials typically provide considerable financial information (both historical in detailing the insolvency of the company and prospective in the form of cash-flow forecasts). In addition, initial orders granted under the CCAA typically provide for creditors to be given such information as may be reasonably requested, provided that such information is not considered confidential. Finally, the public record on court applications may provide additional financial information.

Informal restructuring: The creditors will have access only to publicly available information and such other information as the company chooses to disclose. However, in order to persuade its creditors to accept an informal restructuring proposal, it is usually necessary for the company to provide detailed financial information, results and forecasts.

7. Common questions

7.1 Funding and the priority given to new money

(a) If an insolvent corporation requires urgent working capital funding, what difficulties are likely to be encountered in the provision of such funding?

There is no statutory provision governing DIP financing in a reorganisation. However, Canadian courts have exercised their statutory jurisdiction

and authorised the use of DIP financing in CCAA cases. The court considers factors such as:

- how long it will take to determine whether there is a going-concern solution that creates more value than a liquidation;
- whether the DIP loan will enhance the prospects for a going-concern solution or otherwise facilitate the preservation of the value of the company's assets;
- the nature and value of the company's assets; and
- whether any creditors will be materially prejudiced as a result of the continued operations of the company.

(b) Are lenders providing new money, or debtor-in-possession financing, given any statutory priority?

Canadian courts have allowed the security given to DIP lenders to rank above that of other secured creditors, without having to provide "adequate protection" to such other creditors. However, since DIP financing is not statutorily mandated, a judge has the discretion to refuse to authorise the financing and to refuse to give a DIP lender super-priority over other charges.

7.2 Ranking of creditors

In what order are creditors paid in a corporate bankruptcy/liquidation?

The BIA sets out the priority scheme for the payment of claims against the bankrupt. Secured creditors can look to the assets charged by their security for payment. Thereafter, the BIA provides a list of preferred unsecured claims (eg, certain costs of administration of the bankruptcy process) that are paid in priority to the claims of the general body of unsecured creditors. Non-preferred unsecured creditors (including secured creditors with a deficiency claim) are paid on a without-preference basis.

7.3 Avoidance of antecedent transactions

Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?

Provincial legislation: Where the actions of the company are undertaken with the intent to defeat or defraud creditors, unsecured creditors may

resort to provincial statutory remedies to challenge such actions. For example, in the province of Ontario such statutory remedies are available in the Fraudulent Conveyances Act and the Assignments and Preferences Act.

Oppression remedies: In certain circumstances, creditors may apply to the court in respect of certain acts of the corporation or its directors under the oppression provisions contained in corporate statutes. A court may grant such an application if it is satisfied that the corporation or its directors have committed any act or conducted any business in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards, the interests of any security holder, creditor, director or officer. The court may make any order it deems appropriate including, but not limited to, an order:

- restraining the complained-of conduct;
- appointing a receiver or receiver and manager; or
- liquidating or dissolving the corporation.

The BIA: Trustees (and, with court approval, creditors) may use certain provisions in the BIA to challenge transactions of a bankrupt entered into on the eve of insolvency.

Section 91 of the BIA provides that any settlement of property made within the period beginning one year before the initial bankruptcy event of the settlor and ending on the date on which the settlor became bankrupt is void against the trustee. This one-year period is extended to five years if the trustee can prove that at the time of the settlement the settlor was unable to pay all its debts without the aid of the property comprised in the settlement, or that the interest of the settlor in the property did not pass on the execution thereof. Section 91 does not apply to a settlement made in favour of a purchaser in good faith and for valuable consideration.

Section 95 of the BIA makes fraudulent and void every transfer of property, encumbrance or payment made within three months (or one year in a related-party transaction) of bankruptcy by an insolvent person with a view to prefer a creditor. It is necessary to prove that:

- the bankrupt was insolvent at the time of the transaction;
- the transaction had the effect of preferring the creditor in question; and
- the company intended to prefer the creditor.

Section 100 of the BIA permits the court to

review under-value transactions if the transaction:

- took place during the one-year period preceding the bankruptcy;
- was made for inadequate consideration; and
- took place between the bankrupt and a person not dealing at arm's length with the bankrupt.

Section 101 of the BIA provides a means to challenge the payment of dividends or redemption of shares in certain circumstances where such dividend or redemption occurred one year before the bankruptcy.

7.4 'Cram-downs'

What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or an informal rescue plan?

BIA proposals: Each class of creditors affected by a proposal made pursuant to the BIA must vote on the proposal. In order for a class to approve the proposal, it must be accepted by a majority in number, representing two-thirds in dollar value, of all creditors of such class that vote at the meeting of creditors in person or by proxy.

If the proposal is accepted by creditors, it must then be approved by the court. The court will approve it only if it is satisfied that the terms of the proposal are reasonable and the formalities of the BIA have been complied with. Once the proposal is approved by the court, it becomes binding on the company and all affected creditors. If the secured creditors reject the proposal, they are free to enforce their rights over their security. If the proposal is rejected by the unsecured creditors, the company is automatically deemed to have made an assignment in bankruptcy.

The CCAA: In order for a CCAA plan to be accepted by a class of creditors, it must be accepted by a majority in number, representing two-thirds in dollar value, of all creditors of each class that votes at the meeting of creditors in person or by proxy.

Once a plan has been accepted by the requisite number of creditors, the company will apply to have the plan approved by the court. The court has the discretion to approve the plan, but will not do so until it is satisfied that all statutory requirements have been complied with and that nothing has been done that is not authorised by the CCAA. Furthermore, the court must be satisfied that the plan is fair and reasonable to the constituents. Upon court approval, the plan becomes binding upon all classes of creditor that voted in favour of the plan, including all objecting creditors in such classes.

7.5 Creditor protection

What actions can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?

Initial CCAA court orders usually contain a clause providing that any interested party may return to court within a specified time period to seek to amend or vary the order or to seek any other relief. This clause is particularly important where the initial application was made without notice to interested or affected parties. A comparable provision is also typically contained in receivership court orders. In either type of proceeding, creditors have ready access to the courts, including to challenge motions brought by the company or others and to bring their own motions seeking to lift the stay of proceedings to permit specific actions, seeking to terminate the proceedings or seeking other relief. Initial CCAA and receivership orders commonly contain a provision that prevents a creditor from bringing an action against a monitor or receiver personally without leave of the court.

The BIA also provides that where a creditor is aggrieved by an act or decision of a trustee, the creditor may make an application to the court to confirm, reverse or modify the act or decision and the court may, on any such application, make any order it deems just. In addition, the BIA contains a provision that requires a creditor to apply to the court for leave to bring an action against a trustee.