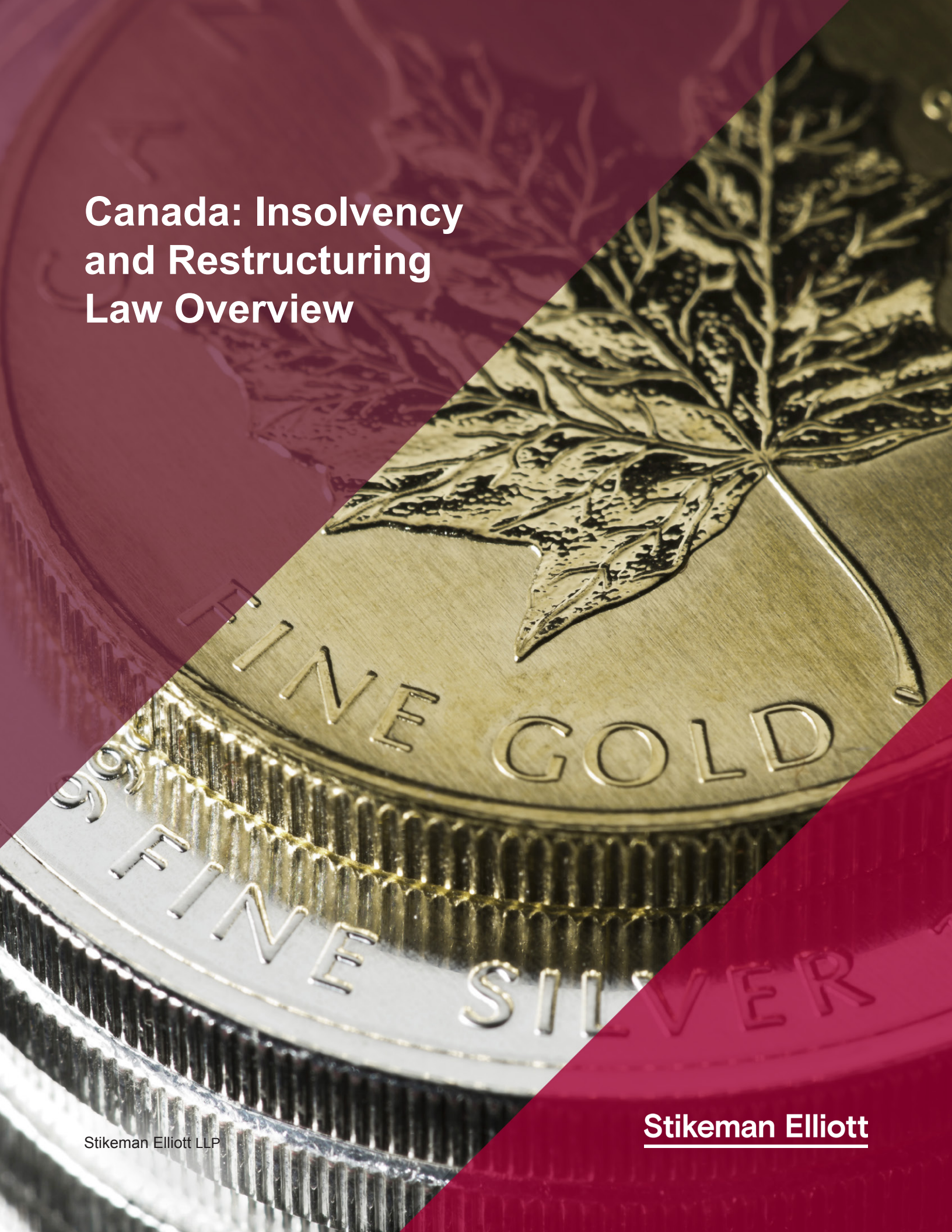
Canada: Insolvency and Restructuring Law Overview



Stikeman Elliott LLP

Stikeman Elliott

Canada: Insolvency and Restructuring Law Overview

Legislative Framework 2

Liquidation Regimes 2

- Bankruptcy and Insolvency Act 2
- Receiverships 3
- Winding-up and Restructuring Act 3

Reorganization Regimes 3

- Bankruptcy and Insolvency Act: Proposals 3
- Companies' Creditors Arrangement Act 4

Cross-border Insolvencies 6

This is Section M of *Doing Business in Canada*, published by Stikeman Elliott.

Canada: Insolvency and Restructuring Law Overview

Legislative Framework

The majority of Canada's insolvency rules are enshrined in two principal federal statutes – the *Bankruptcy and Insolvency Act* (BIA), and the *Companies' Creditors Arrangement Act* (CCAA). A third statute, the *Winding-up and Restructuring Act* (WURA) specifically governs the liquidation and restructuring of certain types of companies including banks, insurance companies and trust companies. Also, several provincial statutes deal with creditors' rights.

Both the CCAA and the BIA can be used for reorganization proceedings and liquidations. The practice has developed to utilize the CCAA for medium to large cases and the BIA for small to medium cases, since the relative flexibility of the CCAA affords greater latitude of action to the reorganizing debtor.

Liquidation Regimes

Bankruptcy and Insolvency Act

The liquidation and bankruptcy scheme under the BIA may be applied in insolvencies of almost any type of entity including individuals, partnerships, associations and corporations. The BIA defines "corporation" to include not only any company incorporated and authorized to do business by or under a federal or provincial act, but also any incorporated company that has an office or property in, or carries on business in Canada. The definition does not include certain entities in the financial services sector such as banks, savings banks, insurance companies, trust companies, loan companies or railway companies (which are subject to the WURA), although holding companies of such entities are subject to the BIA. Income trusts are eligible for protection under the BIA pursuant to amendments enacted in 2009.

Among other things, the BIA allows the trustee in bankruptcy to realize on the assets of the bankrupt, determine the propriety of claims against the estate, and distribute the proceeds. Secured creditors are generally not affected by this proceeding and can, therefore, exercise their rights subject to certain limitations contained in the BIA. Generally, a trustee takes the property of the bankrupt, subject to rights of third parties, which may be pre-existing or created by the BIA. These third parties include secured creditors, unpaid suppliers and the Crown, and vary depending on the right being claimed and the party claiming that right. Certain rights of set-off are also permitted in bankruptcy proceedings.

Preferences and Transfers at Undervalue - The trustee is able to challenge payments or transfers of property at undervalue that have taken place within defined periods prior to the bankruptcy if they have had the effect of defeating or prejudicing the claims of creditors. These types of transactions are called "preferences" or "transfers at undervalue". For preferences, look back periods range from three months (for arm's length creditors) to twelve months (for non-arm's length creditors). Transactions with non-arm's length creditors can be defended as non-preferential where there is no intention to prefer that creditor.

For transfers at undervalue (the disposition of property or provision of services for which inadequate or no consideration was received by the debtor), look back periods range from twelve months (for arm's length creditors) to five years (for non-arm's length creditors). Transactions with non-arm's length creditors can be defended as non-preferential where there is no intention to prefer that creditor.

Receiverships

Liquidation under a court-administered receivership can be commenced under the BIA or a specific provincial statute (e.g. *Courts of Justice Act* (Ontario)) to appoint a receiver to realize on the assets of a business corporation for the benefit of its creditors. Receiverships are often used where continuing the operations of the debtor to maintain value is important and creditors wish to exercise greater control over such operations. Secured creditors may also privately appoint receivers under their security documents to realize on the assets subject to their security interests. Unpaid suppliers are given the right, in certain circumstances, to reclaim goods delivered within thirty days of the debtor in receivership.

Winding-up and Restructuring Act

As mentioned above, liquidation provisions under the federal WURA apply to federal or foreign banks, federal or provincial loan or trust companies, and federal, provincial or foreign insurance corporations carrying on operations in Canada. Although WURA can apply to "trading companies" (except for corporations incorporated under the CBCA), non-financial institution corporations are generally liquidated under the BIA. Although it is framed in different terms, WURA operates in a similar way to the liquidation provisions of the BIA, with some important distinctions.

Reorganization Regimes

Bankruptcy and Insolvency Act: Proposals

The reorganization of creditor claims under the proposal provisions of the BIA applies to the same types of corporations to which the BIA liquidation provisions apply. Under the BIA, a company may deliver a proposal to its creditors or give

notice of its intention to file a proposal. Provided the requisite statements are filed, the delivery of a proposal or a notice of intention to file a proposal effects a thirty-day stay period (which may, at the discretion of the court, be extended for up to six months) against the government and against other secured and unsecured creditors, other than any secured creditors who have taken possession of their security or given notice of their intention to enforce their security at least ten days before the first filing of the notice or proposal. During the stay period, the business is monitored by a proposal trustee while the debtor attempts to negotiate an acceptable proposal with its creditors. If a proposal is not filed within the allowed time, the debtor is deemed to have made an assignment in bankruptcy.

The proposal may be made to unsecured creditors only, or to both secured and unsecured creditors. Creditors with proven claims are entitled to vote on the proposal and are divided into classes based on commonality of interest, with all of the unsecured creditors normally comprising one class. The approval of a proposal by a particular class requires a favourable vote by creditors representing a majority in number and two-thirds in value of those voting. If the creditors accept the proposal, it is submitted to the court for approval.

Subject to certain exceptions for eligible financial contracts, the BIA provides that contractual terms providing for the termination, amendment or acceleration of payment under a contract simply by reason that a person is insolvent or has filed a notice of intention or a proposal will be unenforceable. Similar clauses in leases of real property or licensing agreements that are triggered by the non-payment of rent or royalties will also be unenforceable. Any further supply of goods and services may, however, be on an immediate payment basis.

Companies' Creditors Arrangement Act

Reorganization of creditor claims under the CCAA permits an insolvent company to continue its business while attempting to reorganize its affairs by providing for a stay of proceedings during the reorganization period. Banks, insurance companies, railways and federal loan and trust corporations are not subject to the CCAA, although income trusts are now eligible pursuant to amendments enacted in 2009. In order to take advantage of the CCAA, aggregate claims against the corporation must exceed $5 million.

In response to an application by any eligible CCAA debtor company, creditor, trustee in bankruptcy or liquidator, a court may grant an order directing the filing of a plan of compromise or arrangement, and the meeting of the creditors of the debtor company to consider and vote on the terms of the plan. Unlike the BIA, where the process is automatic, the decision to grant relief in CCAA proceedings is discretionary. In particular, a court may deny an initial CCAA application where support by the creditors is slim and there appears to be no chance that a plan will be successful. In order to succeed, the debtor company's plan of compromise or arrangement must be approved by a majority in number representing two-thirds in

value of the creditors in *each* class. The CCAA requires that secured and unsecured creditors must be in separate classes; other classes may be created based on "commonality of interest."

The court is given complete discretion as to whether to grant a stay, the scope of the stay, and the time period in which the stay is in effect (except that the original stay period cannot exceed 30 days). In particular, the court must be satisfied that a stay is in the best interests of the debtor and creditors. Once a stay is granted, it applies to both secured and unsecured creditors and usually prevents the termination of contracts between the debtor and other parties, although eligible financial contracts are exempted. Suppliers can refuse to extend further credit, in effect, moving to a cash-on-delivery system during the CCAA proceedings. Some major elements of the CCAA include:

Interim (DIP) financing – Where a debtor company has insufficient cash to operate during its CCAA proceedings, the CCAA permits courts to authorize interim financing. The provider of the interim financing has priority over other creditors to the debtor's assets.

Disclaimer of agreements – A debtor company may disclaim an agreement to which it is a party as of the day it enters into CCAA proceedings, on notice to the counterparties to the agreement and the monitor. Eligible financial contracts, collective agreements, financing agreements where the debtor is the borrower and leases of real property and/or an immovable if the debtor is the lessor are not eligible for disclaimer. Eligible financial contracts are defined in the regulations to the CCAA and include, for example, derivatives contracts.

Critical suppliers – A debtor can apply to court to have a person declared a critical supplier, upon which the court may order the person to supply goods and services on terms and conditions that are consistent with the supply relationship or that the court considers appropriate. Where such an order is made, the critical supplier will be entitled to a charge on the debtor's assets in its favour.

Assignment of agreements – A debtor can apply to court to have contracts with third parties assigned without the consent of such third parties. Courts will balance the interests of all parties affected by the assignment in exercising its discretion to assign. Cure costs (other than those arising by virtue of the debtor's insolvency, commencement of CCAA proceedings or the failure to perform a non-monetary obligation) must be paid for the court to approve the assignment. These assignment provisions do not apply to agreements that are not assignable by their nature, collective agreements, eligible financial agreements or agreements entered into during the CCAA proceedings.

Preferences and Transfers at Undervalue – the preferences and transfers at undervalue provisions discussed above apply in CCAA proceedings, with the necessary modifications required by the different statute.

Cross-border Insolvencies

Both the CCAA and the BIA operate on the assumption of universal jurisdiction, extending authority and duty to control the assets of a debtor corporation wherever located (in Canada or abroad) for the benefit of creditors, wherever located. That notwithstanding, Canadian courts have traditionally been open to the concept of comity and the recognition of properly constituted foreign insolvency proceedings wherever this is consistent with public policy, and have generally encouraged coordination among various proceedings in all jurisdictions so that the restructuring or liquidation can proceed in a fair and orderly manner.

In exercising a wide discretion to recognize and enforce a foreign bankruptcy order, Canadian courts have taken a variety of factors into consideration including the compatibility of the foreign jurisdiction's insolvency rules with the Canadian regime. They have authority to tailor the terms and conditions of the orders that can be granted in the course of proceedings, and have formally recognized foreign orders and given assistance to foreign representatives in foreign restructuring proceedings (provided that such recognition is not inconsistent with Canadian laws or public policy).

Part IV of the CCAA and Part XIII of the BIA, which came into force in September 2009, largely harmonize the Canadian insolvency regime with the standards of the United Nations Commission on International Trade Law. Procedural harmonization has been implemented between courts in the US and Canada through the use of Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases and cross-border protocols, the primary purpose of which is to set out guidelines to coordinate and to promote the efficient administration of cross-border restructuring proceedings.

About the Firm

When Heward Stikeman and Fraser Elliott first opened the firm's doors in 1952, they were united in their pledge to do things differently to help clients meet their business objectives.

In fact, they made it their mission to deliver only the highest quality counsel as well as the most efficient and innovative services in order to steadily advance client goals.

Stikeman Elliott's leadership, prominence and recognition have continued to grow both in Canada and around the globe. However, we have remained true to our core values.

These values are what guide us every day and they include:

- Partnering with clients – mutual goals ensure mutual success.
- Finding original solutions where others can't – but they must also be grounded in business realities.
- Providing clients with a deep bench of legal expertise – for clear, proactive counsel.
- Remaining passionate about what we do – we relish the process and the performance that results from teamwork.

A commitment to the pursuit of excellence – today, tomorrow and in the decades to come – is what distinguishes Stikeman Elliott when it comes to forging a workable path through complex issues. Our duty and dedication never waver.

This is what makes Stikeman Elliott the firm the world comes to when it counts the most.

Montréal
1155 René-Lévesque Blvd. W.
41st Floor
Montréal, QC, Canada H3B 3V2
Tel: 514 397 3000

Toronto
5300 Commerce Court West
199 Bay Street
Toronto, ON, Canada M5L 1B9
Tel: 416 869 5500

Ottawa
Suite 1600
50 O'Connor Street
Ottawa, ON, Canada K1P 6L2
Tel: 613 234 4555

Calgary
4300 Bankers Hall West
888 - 3rd Street S.W.
Calgary, AB, Canada T2P 5C5
Tel: 403 266 9000

Vancouver
Suite 1700, Park Place
666 Burrard Street
Vancouver, BC, Canada V6C 2X8
Tel: 604 631 1300

New York
445 Park Avenue, 7th Floor
New York, NY USA 10022
Tel: 212 371 8855

London
Dauntsey House
4B Frederick's Place
London EC2R 8AB
Tel: 44 (0) 20 7367 0150

Sydney
Level 24
Three International Towers
300 Barangaroo Avenue
Sydney, NSW 2000
Tel: +61 (2) 8067 8578

Follow us

Stikeman Elliott

Subscribe to updates on a variety of valuable legal topics from Stikeman Elliott's Knowledge Hub.