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Insolvency 2022

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CANADA

Law and Practice

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1. State of the Restructuring Market

1.1 Market Trends and Changes

Throughout the first and second quarters of 2022, insolvency and restructuring proceedings pursuant to the Bankruptcy and Insolvency Act (BIA) have increased, while proceedings under the Companies' Creditors Arrangement Act (Canada) (CCAA) have declined.

In Q1 of 2022, business bankruptcies were up 30.8% and BIA proposal proceedings up 44.7% from the same quarter in 2021. This upward trend continued in Q2 of 2022, with business bankruptcies up 30.9% and BIA proposal proceedings up 31.1% from Q2 2021.

With respect to proceedings commenced pursuant to the CCAA, there have been 13 CCAA proceedings filed in Q1 and Q2 of 2022, as compared to 17 CCAA proceedings filed in Q1 and Q2 of 2021.

2. Statutory Regimes Governing Restructurings, Reorganisations, Insolvencies and Liquidations

2.1 Overview of Laws and Statutory Regimes

There are three main insolvency statutes in Canada:

- the BIA;
- the CCAA; and
- the Winding-Up and Restructuring Act (WURA).

The BIA governs proposals (a restructuring regime for individuals and small to mid-sized companies) ("proposal"), receiverships ("receivership") and bankruptcies (both personal and corporate) ("bankruptcy"). The CCAA provides a restructuring regime for larger corporations. The WURA is a liquidation statute designed to deal with, among other things, the formal liquidation of certain regulated entities including financial institutions and insurance companies.

2.2 Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receivership

There are five main insolvency processes:

- bankruptcy proceedings;
- proposal proceedings;
- proceedings under the CCAA;
- receiverships; and
- winding-up proceedings under the WURA.

2.3 Obligation to Commence Formal Insolvency Proceedings

There are no express obligations imposed on the directors of a debtor to initiate bankruptcy or restructuring proceedings. However, directors may consider it prudent to commence insolvency proceedings to avoid or minimise statutory liabilities for which the directors may be personally liable by reason of being a director of an insolvent company. Directors may also consider that an insolvency filing is required to avoid any potential claims that the debtor traded while "knowingly insolvent", or that the debtor conducted its affairs in a manner that was oppressive to its stakeholders.

2.4 Commencing Involuntary Proceedings

Involuntary proceedings may be commenced by creditors under four of the five insolvency and restructuring regimes summarised in **2.2 Types of Voluntary and Involuntary Restructurings, Reorganisations, Insolvencies and Receiver-**

ship. Creditors can apply for the appointment of receivers under the BIA or provincial statutes. Creditors with unsecured liquidated claims in excess of CAD1,000 may apply for bankruptcy orders under the BIA where debtors have committed acts of bankruptcy within six months. Creditors can also apply for orders under the CCAA. Involuntary proceedings can be commenced in respect of entities to which WURA applies by:

- creditors in respect of certain companies;
- shareholders; and
- the Attorney General of Canada (AG) in respect of financial institutions over which the Superintendent of Financial Institutions (OSFI) has taken control.

2.5 Requirement for Insolvency

The BIA defines an insolvent person as a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors amount to CAD1,000, and:

- who is for any reason unable to meet their obligations as they generally become due;
- who has ceased paying their current obligations in the ordinary course of business as they generally become due; or
- the aggregate of whose 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 their obligations, due and accruing due.

2.6 Specific Statutory Restructuring and Insolvency Regimes

The restructuring and insolvency regime applicable to banks regulated under Canadian law is governed by both the Bank Act and WURA. Generally, following the exercise of control over a bank by OSFI under the Bank Act, the AG, at the request of OSFI, will seek the appointment of a liquidator and the making of a winding-up order under WURA.

Other financial institutions such as credit unions, insurance companies, loan and trust companies and related businesses are subject to WURA and their home statutes (for example, the Insurance Companies Act, the Trust and Loan Companies Act and the Cooperative Credit Associations Act) with respect to substantive or regulatory matters relevant to winding up under WURA.

Part XII of the BIA applies to the insolvency of "securities firms". Historically, railways have been subject to specific restructuring and insolvency regimes prescribed under their statutes of incorporation; however, in limited circumstances application has been permitted under the CCAA.

3. Out-of-Court Restructurings and Consensual Workouts

3.1 Consensual and Other Out-of-Court Workouts and Restructurings

The effectiveness of consensual out-of-court workouts and restructuring in Canada varies depending on the specific circumstances and business context of the debtor.

There is a perception that doing as much as possible outside formal proceedings, and doing so consensually, can be preferable and tends to preserve stakeholder value. In certain situations, required regulatory approvals and critical contractual relationships mitigate in favour of out-of-court workouts, to avoid triggers or terminating events affecting these relationships. Finally, where possible, consensual workouts can save transaction costs.

It is common practice for financing parties in Canada to use professional financial advisers to obtain detailed assessments of their borrower's position and, in appropriate circumstances with contractual protections, to permit time for this to happen. Although not every case is suitable for forbearance arrangements allowing financing parties to develop a highly informed picture of their borrower's situation, where possible this is preferable.

It is common for significant out-of-court work to be done on the restructuring or workout of distressed companies but to invoke the authority of the courts to complete this work. This is in contrast to the "file first, figure out later" approach.

3.2 Consensual Restructuring and Workout Processes

Forbearance agreements are common. Among other things, these agreements permit borrowers to have a contractual breathing space subject to enhanced credit agreement protections and milestones specific to the financial circumstances of the borrower. The terms of these arrangements vary widely and are context-specific.

Creditors' committees may play a role in consensual restructurings but this will depend on how widely debt obligations of a business are held. First lien financings controlled by syndicates governed by their own internal rules and bilateral financings between one financing party and a borrower are common in Canada, making creditors' committees less important.

Informational requirements in relation to consensual restructuring are common and often additional to those provided for in existing credit documentation.

Priorities tend to be preserved in relative terms during informal restructurings in Canada. Where realisation analysis makes this obvious, compromises in the amount or terms of debt obligations can be made but this will be entirely dependent upon full disclosure and clear information about the economics of the business. In capital structures featuring significant debt components, equity is always in jeopardy in distressed situations.

3.3 New Money

Super-priority liens or rights are not common outside a formal process and could only be practically obtained through contractual subordinations or existing registration or possession priorities. Instead, it is common to seek super-priority for new money in a formal filing. A debtor subject to CCAA or proposal proceedings may obtain interim financing, referred to as debtor-in-possession (DIP) financing.

DIP financing must be approved by the court. A supervising court will consider the following factors (among others) in determining whether to grant an order approving DIP financing:

- the period during which the debtor is expected to be subject to the proceedings;
- how the debtor's business and financial affairs are being managed during the proceedings;
- whether the debtor's management has the confidence of its major creditors;
- whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the debtor (or preserve the value of the debtor's enterprise for the benefit of stakeholders);
- the nature and value of the debtor's property;

- whether any creditor would be materially prejudiced as a result of the security or charge; and
- the monitor's or trustee's report, if any.

Where an order is granted approving DIP financing, a DIP lender may be granted a corresponding priority charge over the debtor's property and assets, and in priority over existing secured creditor claims. The special priority granted to a DIP lender may, however, remain subject to other court-ordered priority charges that are granted. Existing secured creditors will be notified prior to the court granting an order for DIP financing.

Under the CCAA, where the debtor's application for interim financing is made at the same time as the initial application for protection under the Act, the court must be satisfied that the terms of the loan are limited to what is reasonably necessary for the continued operation of the debtor in the ordinary course of business during the ten-day "come-back" period after the granting of the initial order.

3.4 Duties on Creditors

Creditors are subject to limited duties in a formal insolvency process. These include, in the context of proceedings under the BIA and CCAA, the statutory duty to act in good faith with respect to those proceedings. Creditors are also subject to restrictions and obligations that may be included in an order of the court. Subject to compliance with these requirements, creditors can vote and participate in insolvencies in their own individual economic interest.

3.5 Out-of-Court Financial Restructuring or Workout

There is no "cram-down" in an out-of-court restructuring or workout. Indeed, if the landscape of stakeholders is complex and a compromise is required from each, an out-of-court agreement may be elusive. In this regard, out-of-court solutions are normally achieved where a small number of stakeholders are in a position to negotiate a compromise that does not require agreement from a wider group.

It is not uncommon (arguably typical) for large syndicated credits to include provisions permitting a majority (or super-majority) of lenders to bind dissenting lenders. The presence or absence of such provisions and the threshold for the contractual cram-down are a matter of negotiation. Syndicate co-operation in the face of debtor restructurings is the norm, and syndicate conflict is less common because the syndicate members value stable relations across a large number of credits over winning a single syndicate battle. Conflicts do occur but are not common.

Informal processes are not perceived as unworkable. A distressed investor may decide to acquire the secured debt as part of an acquisition transaction arising from an informal restructuring in order to retain that secured creditor's leverage in negotiations with remaining stakeholders after an acquisition is consummated. The implied threat of a formal restructuring, with its declining returns to stakeholders and associated costs of recovery, often facilitates a post-acquisition negotiated solution among rational economic actors.

4. Secured Creditor Rights, Remedies and Priorities

4.1 Liens/Security

In the common law provinces of Canada, security over personal property (both tangible and intangible) is usually taken under a general secu-

rity agreement granting a security interest in all property, undertakings and assets of a debtor. Real property can be charged by way of a mortgage registered on title. In addition to a general security agreement, a lender may wish to take specific types of security against specialised personal property such as shares, which can be accomplished by way of a supplementary share pledge. Debenture security may also be taken over real and personal property. Banks licensed in Canada can take specialised types of security under the Bank Act.

In the province of Quebec, the only civil law jurisdiction in Canada, security is obtained by way of hypothecs that can charge both movable and immovable property.

4.2 Rights and Remedies

Outside of an insolvency process, secured creditors may exercise their contractual rights and avail themselves of the sale and foreclosure regimes prescribed by real and personal property legislation. These regimes prescribe statutory notice periods. Additionally, if a creditor is seeking to enforce on all or substantially all of a debtor's property, it is required under the BIA to provide ten days' notice of its intention to enforce its security.

In formal insolvency proceedings (other than bankruptcy), secured creditors are subject to the stay of proceedings, subject to limited exceptions. For instance, if the ten-day notice period described above has elapsed, a secured creditor will not be subject to the stay of proceedings in a proposal proceeding. In a bankruptcy, secured creditors are not stayed and may enforce their rights.

4.3 Special Procedural Protections and Rights

Under the BIA, the vesting of title to a debtor's assets in the trustee in bankruptcy ("trustee") and distributions to unsecured creditors are subject to the claims of secured creditors. To the extent of their validity, enforceability and perfection, and subject to limited statutory priorities, secured creditors have priority against a trustee and unsecured creditors. A bankruptcy order does not stay secured creditors.

5. Unsecured Creditor Rights, Remedies and Priorities

5.1 Differing Rights and Priorities

In an insolvency, creditors' claims generally rank as follows.

- Super-priority claims, including:
  - (a) valid trust claims;
  - (b) realty property taxes;
  - (c) certain deemed trusts;
  - (d) claims for specified amounts and periods for wages and pension contributions;
  - (e) qualified unpaid supplier or "30-day good" claims; and
  - (f) court-ordered charges in CCAA, proposal and receivership proceedings.
- Secured claims.
- Preferred unsecured claims, including:
  - (a) limited landlords' claims;
  - (b) amounts that would have been paid to a secured creditor but for the payment of wage and pension claims; and
  - (c) certain workers' compensation claims.
- General unsecured claims.

Super-priority and secured claims are paid out of proceeds from sales during the insolvency proceedings in accordance with their respec-

tive priority. Where there is a surplus following satisfaction of super-priority and secured claims, the surplus is distributed to preferred unsecured claims and then ratably among general unsecured creditors.

Claims of creditors have priority over the claims of shareholders.

5.2 Unsecured Trade Creditors

Unsecured creditors are not required to supply goods or services, or provide credit, to a debtor without assurance of payment for post-filing goods or services. Unsecured creditors may require that any such goods or services be provided strictly on a cash on delivery basis. They are therefore able to ensure they are kept whole during the restructuring process for post-filing goods or services.

5.3 Rights and Remedies for Unsecured Creditors

Unsecured creditors have the right to commence an action to recover their debt and apply to court for an order adjudging the debtor bankrupt. These remedies are stayed when insolvency proceedings begin. Unsecured creditors have the ability to prove their claim in a bankruptcy, CCAA plan or proposal and receive a dividend based on the pro rata value of their claims relative to the claims of all other unsecured creditors.

5.4 Pre-judgment Attachments

Pre-judgment attachment is available to creditors in appropriate circumstances. Laws of general application and those specific to restructuring and insolvency provide for general attachment.

Remedies under laws of general application include court orders providing for injunctive relief, prohibiting certain acts by debtors or prescribed dealings with particular assets. In addition, "Mareva" injunctions can prohibit debtors from dissipating or concealing assets, or transferring assets out of jurisdiction.

Secured and unsecured creditors seeking bankruptcy orders have remedies that share some of the characteristics of pre-judgment attachments. A secured creditor who has delivered a notice of intention to enforce security under Section 244 of the BIA (a "244 Notice") may seek the appointment of an interim receiver to conserve the debtor's estate, pending the expiry of the applicable ten-day notice period. An unsecured creditor who has filed a bankruptcy application may seek the appointment of an interim receiver to conserve the debtor's property, pending the hearing of the bankruptcy application.

5.5 Priority Claims in Restructuring and Insolvency Proceedings

The BIA and CCAA provide the court overseeing CCAA, proposal and receivership proceedings jurisdiction to make orders granting super-priority charges that will rank ahead of secured creditors to the extent such creditors have received notice of the proposed charges. The charges can include the following.

- Administration charge securing the fees and disbursements of the debtor's and court officer's legal and financial advisers ("receiver's charge").
- Interim financing charge securing DIP financing ("receiver's borrowing charge").
- Directors' and officers' charge securing the indemnity provided by the debtor to its directors and officers for liabilities that they might incur in their capacities as directors and officers during the course of the proceeding. In CCAA and proposal proceedings only.
- Critical supplier charge. In both CCAA and proposal proceedings, the court has the

authority to order a critical supplier to continue to supply following the commencement of the proceedings provided that the court also issues an order securing the post-filing payment obligations to that supplier.

The BIA also contains statutory provisions granting priority charges (or similar protections in the context of CCAA proceedings) protecting employees' claims for unpaid wages and vacation pay for the six-month period preceding the commencement of the proceedings, up to CAD2,000 per employee. The charge covers accounts receivable, inventory and cash of the debtor. A similar charge against all assets of the debtor protects certain prescribed unremitted pension contributions. Finally, the CCAA provides that a court may not approve a CCAA plan unless it is satisfied that an employer's unremitted source deductions (such as income taxes, unemployment insurance premiums and Canada Pension Plan premiums) that were outstanding at the time of filing will be paid during the six-month period following implementation of the CCAA plan.

6. Statutory Restructuring, Rehabilitation and Reorganisation Proceedings

6.1 Statutory Process for a Financial Restructuring/Reorganisation

CCAA and proposal proceedings are the main Canadian restructuring proceedings. An alternative to these proceedings, in certain circumstances, are the arrangement provisions contained in the Canada Business Corporations Act and equivalent provincial corporate statutes.

CCAA Proceedings

The principal objective of the CCAA is to enable a debtor to formulate a plan of compromise or arrangement (the "plan") in respect of the obligations it owes its creditors, to be voted on by the creditors, and if approved by the requisite majorities in each class of creditors, sanctioned by the court.

In many CCAA proceedings, the debtor will not file a plan but will rather use the proceedings as a mechanism to effect a sale of all or part of its business, property or assets, through either the implementation of a sale process, or a pre-packaged sale transaction that was formulated prior to, but is consummated as part of, the CCAA proceedings.

Either a creditor or the debtor can initiate CCAA proceedings by application to the court.

To proceed under the CCAA, the debtor must:

- be insolvent, meaning that the debtor is unable to meet its liabilities as they fall due (cash flow test), or the debtor's assets are less than its liabilities (balance sheet test); and
- have debts in excess of CAD5 million (including any affiliate companies' debts).

The court will exercise its discretion to grant protection if:

- a reorganisation, or orderly sale or liquidation of the debtor's business would be beneficial to the debtor's stakeholders;
- the debtor does not have an improper motive for making the application; and
- the relief being sought pursuant to the initial order under the CCAA (the "initial order") is limited to that which is reasonably necessary for the continued operation of the debtor in

the ordinary course of business during the initial ten-day stay period.

Provided the applicant establishes that the debtor meets the CCAA requirements, the burden will be on any opposing creditors to show why the court should not grant the relief requested.

The court will appoint a monitor that is a licensed insolvency trustee (LIT), to oversee the proceedings, report on the debtor's business and financial affairs, and assist the debtor in formulating its plan.

The debtor remains in control of its business and property; however, it remains subject to the monitor's scrutiny. If a transaction is outside the ordinary course of business or does not comply with any court order, the monitor will report such activities to the court.

The court will issue an initial order prohibiting all persons from taking any further steps to pursue claims against the debtor and its directors and officers, without the prior consent of the debtor and monitor, or leave of the court.

CCAA proceedings do not have a prescribed time limit. The initial order grants the debtor up to ten days of protection from its creditors. Before the expiry of that period, the debtor must return to court to request an extension. There is no limit on the length or number of extensions that a debtor may seek from the court, provided the applicant shows that circumstances exist that make the order appropriate and that it has acted and is acting in good faith and with due diligence.

For a plan to be accepted by creditors, a meeting must be held for voting on the plan, and a majority in number of each class of creditors holding two-thirds in value of the total debt represented by that class must vote in favour of the plan. Once the requisite majorities of creditors in each class approve the plan, the court must sanction it before it becomes binding on all creditors.

After the implementation of the plan and the conclusion of the proceedings, the debtor can resume its normal business operations.

BIA Proposal

The objective of proposal proceedings is to enable a debtor to reach a compromise with its creditors through a restructuring of its obligations pursuant to a proposal. The debtor may also use proposal proceedings to effect a sale of all or part of its business or assets.

An insolvent person, a receiver, a liquidator, a bankrupt or a trustee may make a proposal. There is no minimum debt requirement for companies to be eligible to make proposals. A proposal is initiated by filing a proposal or a notice of intention to make a proposal (NOI).

To proceed with a proposal, the debtor must:

- be insolvent under the cash flow or balance sheet test;
- have at least CAD1,000 in unsecured indebtedness.

The Office of the Superintendent of Bankruptcy (OSB) will appoint a trustee to supervise the proposal. Its role is to monitor the debtor's actions, assist it in developing the proposal, and advise the court if any material adverse changes occur.

The debtor remains in control of its property; the trustee does not control the debtor's affairs.

Once a proposal or NOI has been filed, no creditors can bring or continue any proceedings against the debtor. The stay of proceedings prohibits creditors from exercising any remedy against the debtor or its property, or commencing or continuing any action, execution or other proceeding for the recovery of a claim provable in bankruptcy without leave of the court granted on motion on notice to the debtor and the proposal trustee.

Secured creditors may enforce their security only if they have a 244 Notice and the statutory ten-day notice period has lapsed or been waived by the debtor. All other creditors are stayed for an initial period of 30 days. The time for filing a proposal (and the stay period) can be extended by the court for a maximum period of six months (including the initial 30-day stay), in 45-day intervals.

BIA proposal proceedings proceed on defined time limits. On the filing of an NOI, all creditors are stayed for an initial period of 30 days. The time for filing a proposal (and the stay period) can be extended by the court for a maximum period of six months (including the initial 30-day stay), in 45-day intervals.

Both the debtor's creditors and the court must approve a BIA proposal pursuant to the BIA. At least two-thirds in value and a majority in number of the creditors, including secured creditors to whom the proposal was made, must approve of the proposal. Following the creditors' approval, the court will approve the proposal if it is for the general benefit of the creditors. To this extent, evidence must be adduced to show that the debtor's creditors will be better off under the terms of the proposal than they would be if the debtor were liquidated pursuant to bankruptcy proceedings.

Once the debtor has fulfilled all of its obligations as set out in the BIA proposal, the trustee will issue a certificate confirming the debtor's full compliance with its obligations under the proposal. Once the trustee's certificate is issued, the debtor is considered to have completed its restructuring and may resume its normal business operations. However, if the debtor defaults on its obligations to its creditors under the proposal, as approved by its creditors and the court, its proposal may be annulled. Similarly, if a debtor's proposal is rejected by creditors by a majority in number or one-third by value, the debtor will be deemed to be bankrupt.

6.2 Position of the Company

Proceedings under the BIA and CCAA result in the debtor obtaining a stay of proceedings, whether automatically by statute or by order of the court.

A debtor subject to CCAA or proposal proceedings may obtain DIP financing (see **3.3 New Money**).

6.3 Roles of Creditors

For the purposes of voting on proposals or plans under the CCAA, creditors are placed in classes. The voting requirements in proposals and plans (a majority in number and two-thirds by value of the creditors present and voting at a properly constituted meeting) apply on a class-by-class basis. Proposals must be made to all unsecured creditors, classed as is appropriate, and may be made to secured creditors.

Creditors are organised into classes based on their commonality of interest.

There is no statutory basis for creditors' committees in Canada and they are not common. Creditors form ad hoc committees in some cases.

The BIA and CCAA contain disclosure requirements. These include duties on court officers and debtors such as:

- filing of debtor's statements of affairs;
- delivery by debtor of cash-flow projections, together with reports on their reasonability by court officers;
- material adverse change reports by court officers;
- reports in respect of proposals and plans; and
- creditor notices and lists of creditors.

Receivers and trustees also have disclosure requirements which include creditor notices, creditor lists and discharge reporting.

The CCAA also permits "interested persons" to apply for orders requiring a creditor to disclose any aspect of its economic interest in the debtor.

6.4 Claims of Dissenting Creditors

There is no provision permitting an inter-class "cram-down". Proposals and plans will be binding on dissenting creditor minorities within a class if approved at a properly constituted meeting by the requisite majorities and subsequently sanctioned by the court. If court approval is not granted for a proposal or plan, it will not be binding on an affected class.

6.5 Trading of Claims Against a Company

There are no general restrictions on trading the debt of a company undergoing a formal restructuring. Such claims may be recognised as provable claims. Trading of such claims can be structured as either assignments or outright sales. There is no strict time limit on when any claims may be traded. Claims purchasers need to be mindful of claims bar dates and claims procedures implemented in insolvency proceedings.

6.6 Use of a Restructuring Procedure to Reorganise a Corporate Group

Multiple debtors within a corporate group can commence insolvency proceedings. Procedural (or administrative) consolidation can avoid unnecessary multiplicity of proceedings. Under procedural consolidation, estates of related debtors are jointly administered but each debtor's assets and liabilities are kept separate.

It is rare for a court to allow "substantive consolidation", ie, a consolidation of the assets and liabilities of multiple debtors. The situations where such relief is granted are limited given the prejudice it may have on creditors.

6.7 Restrictions on a Company's Use of Its Assets

As a general principle, a debtor will seek court approval prior to the sale of assets that are non-de minimis in value.

In CCAA and receivership proceedings, the initial order and appointment order set out a dollar threshold at which court approval must be obtained prior to consummating a sale transaction.

In determining whether a transaction should be approved, a court will consider, among other things:

- whether sufficient effort has been made to maximise the purchase price;
- the interest of all stakeholders in the transaction;
- the efficacy and integrity of the process by which the assets were marketed; and
- whether there has been unfairness in the marketing process.

6.8 Asset Disposition and Related Procedures

The structure and process for disposal of assets or sale of a going concern business in an insolvency context depend on which insolvency legislation is being used to transact the sale.

The CCAA

With limited exceptions, the debtor runs the process for assets and going concern sales. Following negotiations with its primary creditors, the debtor will often seek approval of the court for an order that prescribes a sales and investment solicitation process (SISP) that involves varying degrees of involvement of, and supervision by, the monitor. Where the board of directors or management of the debtor is unwilling to be involved in the SISP, is not resourced sufficiently to run it or is in a conflict of interest (ie, debtor management/shareholders are potential buyers) the court may order the monitor to have a much higher degree of control over the SISP. DIP lenders and secured creditors (often but not always the same or related entities) may also be granted rights to information and input into a SISP. The court may permit or even mandate the hiring of a “sales agent” to run the SISP.

Going concern sales and sales of assets in bulk or by lot of “material” assets will require approval of the court. In such circumstances, the debtor will apply to the court for an approval and vesting order. This order will approve the sale transaction and also provide for a vesting out of all pre-existing secured and unsecured claims against the purchased assets such that the buyer acquires the debtor’s title free and clear of claims and liabilities asserted against those assets.

It is also possible to use a formal CCAA compromise or plan of arrangement to have a plan sponsor acquire the equity of the debtor (extinguishing all pre-plan equity) and have a plan approved by the affected creditors which would permit the acquisition in return for a payment of a compromised amount of the liabilities to the creditors. The funding of that compromise payment would form part of the plan and would be made by the plan sponsor upon successful plan implementation. The plan sponsor would then acquire the business subject only to uncompromised liabilities it has agreed to assume.

BIA Proposal

The board of directors and management of the debtor generally run any sale process. Like the CCAA context, there may be a SISP. The proposal trustee appointed under the BIA to help the debtor will generally be involved in any sale process and will help board of directors and management of the debtor consummate a sale. If that sale process does not result in a transaction, it is likely that the court will be asked by creditors to convert the BIA proposal process into a receivership or a bankruptcy.

Acquirers in a BIA proposal sale process will also have the benefit of an approval and vesting order.

Receivership

In a court-appointed receivership, the receiver will either sell the assets of the business in bulk or in lots. Where the receiver is operating the business as a going concern, it may attempt to sell the business as a going concern; however, the sale will still take the form of an asset sale. The receiver is an officer of the court who must act in the interest of all creditors; however, in conducting a sale process, the receiver will usually consult creditors who are likely to be impacted by the transaction, typically secured

creditors since few receiverships result in payments to unsecured creditors.

Acquirers in a court-appointed receivership proceeding will also have the benefit of an approval and vesting order.

BIA Bankruptcy

If a debtor is adjudged a bankrupt or assigns itself into bankruptcy, the sale of assets will be run by the bankruptcy trustee for the benefit of the unsecured creditors. A bankruptcy trustee can only sell the assets of the debtor not encumbered by security unless the secured creditor consents to the trustee's sale or the secured creditor seeks the appointment of the trustee also as a court-appointed receiver of the bankrupt debtor.

Credit Bids

Secured creditors can, and frequently do, credit-bid in CCAA, BIA proposal and receivership proceedings, and these can be structured as stalking horse bids. Sales under these regimes are all court-supervised as noted above, and as such there are no special rules for them beyond the test of the prudency of the sale used by court in that context.

Unsecured credit bids are uncommon given the propensity of Canadian secured creditors to take "blanket security" and given the significant shortfalls suffered by unsecured creditors.

Pre-Packs

Pre-negotiated or pre-packaged sales processes are not uncommon. Most often, a pre-packaged sale process follows an informal SISP run prior to the proceeding which lends credibility to an abbreviated process post-filing. The debtor enters the proceeding with the bird in hand being either a stalking horse bid requiring an abbreviated post-filing SISP process or a sale to be approved immediately following filing with compelling evidence to support the abridgement or complete avoidance of a post-filing sale process. Pre-packaged sales require either a significant pre-filing SISP process or some existential threat to the value of the business necessitating an expedited sale approval. It is common in such circumstances for the key stakeholders who might object to the abbreviated or eliminated post-filing sale process to be supporting the application for an expedited process.

6.9 Secured Creditor Liens and Security Arrangements

It is common as part of any sale approved by the court that all secured claims and liens that are attached to the assets being sold be vested out by order of the court so that the purchaser obtains clear and free title to the assets.

6.10 Priority New Money

Additional financing can be obtained by the debtor subject to insolvency proceedings. This financing is called interim financing or DIP financing and is available in CCAA proceedings and BIA proposals; see **3.3 New Money**.

6.11 Determining the Value of Claims and Creditors

The BIA requires creditors to formally prove their claim against the insolvent debtor in order to vote on and participate in proposals. The BIA provides prescribed forms and procedures for proving claims. Claims are adjudicated in the first instance by the proposal trustee, subject to rights of appeal to the court. Claims not proven in advance of a creditors meeting cannot be voted. Claims not proven prior to the implementation of a proposal cannot participate.

Under the CCAA, the supervising court commonly makes orders prescribing the procedure for proving and determining claims and establishing dates after which they will be barred as against the insolvent debtor if not proven. Generally, monitors appointed in CCAA proceedings administer these claims processes.

6.12 Restructuring or Reorganisation Agreement

Proposals under the BIA and plans of compromise or arrangement under the CCAA are not binding unless approved by the supervising court, even if approved by the requisite creditor double majorities. Before approving a proposal or plan, the court must be satisfied that the proposal or plan is fair and reasonable and that the provisions of the applicable insolvency statute and any prior court orders have been strictly complied with. In determining the fairness and reasonability of a proposal or plan, courts will compare the treatment of creditors under the proposal or plan with the treatment that they would receive in bankruptcy or liquidation.

Insolvent debtors restructuring under the BIA or the CCAA are specifically empowered to disclaim executory contracts, with certain exceptions. In order to disclaim a contract, debtors must obtain the approval of the applicable court officer and provide notice in the prescribed form to the contract counterparty. Contract counterparties may object to the disclaimer of their contracts within 15 days of the giving of notice and apply to the court for an order giving effect to their objection. A court will consider whether the proposed disclaimer is approved by the court officer, whether it will enhance the prospect of a viable proposal or plan being made and whether it is likely to cause significant hardship to the contract counterparty. The following contracts are not subject to disclaimer:

- eligible financial contracts;
- collective agreements;
- financing agreements if the debtor is the borrower; and
- leases of real property if the debtor is the lessor.

In addition to the above-named exceptions, Canadian courts have also found that an option to purchase land is a proprietary interest that cannot be disclaimed under the BIA nor vested off pursuant to a vesting order.

6.13 Non-debtor Parties

A court supervising restructuring proceedings may make an order releasing claims against parties other than the debtor provided that the court is satisfied that the releases are reasonably connected to the restructuring. The court will consider:

- whether the parties to be released are necessary and essential to the restructuring;
- whether the claims to be released are rationally connected to the purpose of the plan;
- whether the plan can succeed without the releases;
- whether the parties being released are contributing to the plan;
- whether the releases benefit the debtors as well as the creditors generally;
- whether the creditors voting on the plan have knowledge of the nature and the effect of the releases; and
- whether the releases are fair, reasonable and not overly-broad.

Third-party releases have included professionals involved in the restructuring, secured creditors, and affiliates of the debtor. Third-party releases have also been included in corporate plans of

arrangement though they have been met with some reluctance by the courts.

6.14 Rights of Set-Off

During insolvency, a right of set-off can arise by law, in equity or by contract.

Legal set-off. There are two requirements that must be met for the claim of legal set-off to be made:

- the cross-claims must be liquidated, enforceable and mature; and
- the claims must have arisen between the same parties acting in the same capacity (the claims must be mutual).

Equitable set-off. When determining whether equitable set-off is available, the courts will inquire into the connection between the claims and examine the general equities between the parties. Equitable set-off is available where it would be manifestly unjust to allow one claim to be enforced without taking the other claim into account.

Contractual set-off. The remedy of contractual set-off is the recognition of the entitlement of parties to explicitly contract to allow for setting-off obligations owing between them. A party with a contractual entitlement to set-off is not required to meet the threshold for legal or equitable set-off.

6.15 Failure to Observe the Terms of Agreements

Under the BIA, where there is default in the performance of a proposal, the proposal trustee must give notice of default to the creditors and the government insolvency regulator. Following default, or where it is determined that the proposal cannot continue without injustice or undue delay, the court is empowered to order that the proposal be annulled. The court may also annul proposals obtained by fraud. If a proposal is annulled, the debtor will be deemed to have made an assignment in bankruptcy and a trustee will be appointed.

Under the CCAA, where there is default in the performance of a plan, upon application by a creditor or the monitor, the court is empowered to make whatever order is just in the circumstances, including an order adjudging the debtor to be bankrupt.

6.16 Existing Equity Owners

Equity claimants may not vote at a meeting of creditors unless the court orders otherwise. Proposals and plans cannot provide for the payment of equity claims unless all other claims are paid in full.

7. Statutory Insolvency and Liquidation Proceedings

7.1 Types of Voluntary/Involuntary Proceedings

Bankruptcy

The formal liquidation of an insolvent debtor is most commonly carried out through bankruptcy proceedings pursuant to the BIA. In the context of liquidation, bankruptcy is intended to provide for the fair distribution of the debtor's unencumbered assets among its unsecured creditors.

In bankruptcy, the pre-bankruptcy remedies of a debtor's unsecured creditors are replaced with the right to file a claim and receive a dividend in the distribution of proceeds resulting from the liquidation of the bankrupt debtor's unencumbered assets. However, secured creditors of a

bankrupt debtor can also enforce their security outside of the administration of bankruptcy.

Under the BIA, a debtor is considered bankrupt when it:

- has debts of at least CAD1,000 owing to its creditors; and
- has committed an act of bankruptcy within the six months before the application for a bankruptcy order (which may include having become insolvent and unable to meet its financial obligations generally as they become due).

A bankruptcy can be initiated in three ways where the debtor is insolvent:

- voluntary assignment into bankruptcy where proceedings are commenced by the trustee selected by the debtor filing an assignment in bankruptcy made by the debtor with the OSB;
- involuntary bankruptcy by order of the court on application by one or more creditors; or
- bankruptcy as a result of the failure of proposal proceedings under the BIA.

For a corporate debtor, voluntary initiation also requires the company's board of directors to pass a resolution before the court approving the assignment into bankruptcy.

Once the bankruptcy is effective, all the debtor's property and assets vest in the trustee (subject to the rights of secured creditors) and the debtor ceases to have any control over its affairs. In a corporate bankruptcy, the trustee replaces the management of the corporation and assumes full control over all of the debtor's assets and property. On bankruptcy, the trustee proceeds to administer the estate for the benefit of the bankrupt's unsecured creditors. Secured creditors retain their right to enforce on their security, provided they do so in a commercially reasonable manner.

In order to participate in any distribution of the bankrupt's estate, a creditor must file a proof of claim with the trustee in the manner and form prescribed under the BIA. Where such a claim is allowed, said creditor will, in accordance with the priority regime set out under the BIA, be eligible to potentially share in the recovery from any realisation on the property of the bankrupt debtor. Creditors whose claims are disallowed by the trustee may appeal the trustee's decision to the court.

The debtor's assets are distributed to unsecured creditors on a pro rata basis in accordance with the creditors' proven claims. Such distributions are made only after secured creditors have realised their security and after super-priority and preferred creditors have been paid.

Under the BIA, a bankrupt corporation is not eligible to obtain a discharge from bankruptcy unless it has satisfied the claims of creditors in full. There is no specified timeline for corporate bankruptcy proceedings.

Once the trustee has administered the estate for the benefit of the bankrupt's unsecured creditors, the trustee applies to the court for a discharge from its duties.

Receivership

The BIA provides for the enforcement of security and the appointment of a receiver on a national basis. A 244 Notice must be delivered prior to a secured creditor enforcing its security on all or substantially all of the property and assets of an insolvent debtor. Once the 244 Notice period

has lapsed (or if the debtor has consented to an earlier enforcement at the time of the delivery of the 244 Notice), a secured creditor may proceed with applying for the appointment of a receiver.

The jurisdiction for the court appointment of a receiver is found in the applicable provincial judicature acts, in the rules for court proceedings, under Section 243 of the BIA, and under certain specific statutes (for instance, securities legislation).

The court appointment of a receiver typically commences by a secured creditor bringing an action or application against the debtor. The receiver is then appointed in a summary proceeding within that action or application.

A court order appointing a receiver typically:

- stays proceedings against the receiver and debtor;
- provides the receiver with control over the property and assets of the debtor;
- authorises the receiver to carry on the debtor's business and to borrow money on the security of the assets;
- ultimately authorises the receiver to sell the debtor's property and assets with the approval of the court; and
- authorises the receiver to commence and defend litigation in the debtor's name.

Unlike privately appointed receivers, whose duty is primarily to the appointing secured creditor (subject to a general duty to act in a commercially reasonable manner), a court-appointed receiver is an officer of the court and has a duty to protect the interests of all the debtor's creditors.

Restructuring Proceedings

The main restructuring and rescue procedures in Canada are proceedings pursuant to the CCAA and proposal proceedings pursuant to Part III of the BIA.

In addition, the arrangement provisions contained in the Canada Business Corporations Act and equivalent provincial corporate statutes may be used as an alternative to the formal insolvency proceedings outlined below.

CCAA proceedings

See **6.1 Statutory Process for a Financial Restructuring/Reorganisation**: **CCAA Proceedings**.

Debtor-in-possession regime

The CCAA is a DIP regime, meaning the debtor remains in control of its business and its property and assets. However, the debtor remains subject to the monitor's scrutiny and, if a transaction is outside the ordinary course of business or does not comply with any court-imposed restrictions, the monitor will report such activities to the court. The debtor is subject to the overall supervision of the court.

Where a debtor is granted protection under the CCAA, the court will issue an initial order prohibiting all secured and unsecured creditors from taking any further steps to pursue any existing or future claims against the debtor and its directors and officers, without either the prior consent of the debtor and monitor or leave of the court.

CCAA proceedings do not have a prescribed time limit. After the making of the initial order, the debtor is granted up to ten days of protection from its creditors. Within the initial stay period, the debtor must return to court to request an extension. After the initial protection period,

there is no limit on the length of any extension or on the number of extensions that a debtor may seek from the court, provided that circumstances exist that make the order appropriate and that the applicant has acted and is acting in good faith and with due diligence.

For a reorganisation plan to be accepted by creditors, a meeting must be held for the purpose of voting on the reorganisation plan, and a majority in number of each class of creditors holding two-thirds in value of the total debt represented by that class must vote in favour of the plan. Once the reorganisation plan is accepted by the requisite majority in each class of creditor, the plan must be approved by the court before it becomes binding on those classes of creditors that voted in favour of the plan.

Once the CCAA reorganisation plan is approved by the requisite majority of the debtor's creditors in each class and is thereafter sanctioned by the court, the debtor will have successfully concluded a compromise or arrangement with its creditors with regard to the debts owed to such creditors before the commencement of CCAA proceedings, provided that the payments or consideration required under the CCAA and the plan are made or provided when required.

After the implementation of the plan and at the conclusion of the CCAA proceedings, the debtor can resume its normal business operations.

BIA proposal

See **6.1 Statutory Process for a Financial Restructuring/Reorganisation: BIA Proposal**.

7.2 Distressed Disposals

See **6.8 Asset Disposition and Related Procedures** for court-supervised disposal of assets and businesses.

Distressed sales of assets and/or businesses can and do occur outside of the formal insolvency court proceedings highlighted in **6.8 Asset Disposition and Related Procedures**. However, such "self-help" or "consensual" sales processes:

- must be transactions requiring consensual arrangements between the debtor and its secured creditors where the creditors are not recovering all of their secured debt from the proceeds of such sale transactions; or
- require notice of sale or notice of foreclosure to be issued by a secured creditor under applicable provincial personal property security legislation and mortgage legislation.

The statutory distribution schemes for the proceeds of sale flowing from any such statutory notices of sale are prescribed by legislation and cannot be altered except by consensual arrangements made with secured creditors who otherwise have the protection of the priority scheme thereunder.

If the sale transaction is consensual, the purchaser contractually confirms the release of security with the secured creditors. If the transaction is under the above-noted provincial enforcement regimes in order to obtain clear title free of secured claims, the enforcing creditor must be a first-ranking creditor thereunder. Otherwise, prior-ranking security is not impacted by the notice of a subordinate ranking secured creditor. Court approval and vesting orders provide the highest degree of certainty where priority in the debtor's collateral is in dispute.

Credit bids generally occur in the context of a formal proceeding. However, it is possible to structure debt-to-equity conversions/debt forgiveness transactions where a secured creditor

acquires equity in the debtor by private agreement and generally as a part of a recapitalisation of the debtor outside of formal proceedings.

7.3 Organisation of Creditors or Committees

In bankruptcy, creditors of the bankrupt appoint inspectors to represent their interests. Appointing an inspector is mandatory in corporate bankruptcies. Inspectors may also be appointed in proposal proceedings; however, this is optional.

There is no requirement or statutory framework under the CCAA or the BIA for the formation of creditors' committees. Creditors' committees have been recognised by courts in limited circumstances and granted court-approved funding.

8. International/Cross-Border Issues and Processes

8.1 Recognition or Relief in Connection With Overseas Proceedings

Both the CCAA and BIA contain provision allowing for recognising and co-ordinating with foreign proceedings as either a foreign main proceeding or a foreign non-main proceeding.

A foreign proceeding will be recognised as a foreign main proceeding in Canada where the debtor's centre of main interest (COMI) is located in the foreign jurisdiction. A court will determine a debtor's COMI by looking to, among other things, the location of the debtor's management and headquarters, and the location that significant creditors recognise as being the centre of the debtor's operations.

The definition of a "foreign non-main proceeding" in Canada is derived from the UNCITRAL Model Law on Cross-Border Insolvency 1997 and refers to any foreign proceeding other than a foreign main proceeding.

8.2 Co-ordination in Cross-Border Cases

In limited circumstances, Canadian courts have entered into protocols with foreign courts to co-ordinate cross-border proceedings.

8.3 Rules, Standards and Guidelines

Whether the proceeding is determined to be a foreign main or non-main proceeding by a Canadian court has important implications on the treatment of that proceeding and the debtor in Canada. If the proceeding is determined by the Canadian court to be a foreign main proceeding, the debtor is entitled to certain automatic relief by the Canadian court.

The recognition provisions of the BIA and CCAA are largely modelled on the UNCITRAL Model Law on Cross-Border Insolvency. Canada passed legislation adopting the treaty in 2005.

8.4 Foreign Creditors

Foreign creditors are dealt with in the same manner as domestic creditors. That being said, absent a recognition order in their local jurisdiction, foreign creditors will not be subject to the stay of proceedings in their home jurisdiction.

8.5 Recognition and Enforcement of Foreign Judgments

Canadian courts may recognise foreign judgments. In recognising a foreign judgment, Canadian courts will consider:

- whether the judgment was granted by a court of "competent jurisdiction";
- whether it is final and conclusive; and
- whether it is sufficiently clear and specific.

There are a number of defences to recognising a foreign judgment, including on public policy grounds. Once recognised, a foreign judgment can be enforced in a manner similar to a domestic judgment.

9. Trustees/Receivers/Statutory Officers

9.1 Types of Statutory Officers

Trustee in bankruptcy. In bankruptcy, the debtor's property vests in the trustee (subject to the rights of secured creditors) and the debtor ceases to have control over its affairs. The trustee replaces the management of the corporation and assumes control over the debtor's assets. The trustee administers the estate for the benefit of the bankrupt's unsecured creditors. Secured creditors retain their right to enforce on their security. Trustees are licensed by the OSB to carry out the administration of all aspects of a bankruptcy. Trustees are court officers and act as fiduciaries for the benefit of the bankrupt's creditors.

Monitors. A monitor oversees the proceedings, reports on the debtor's business and financial affairs and assists the debtor with the formulation of its plan. The monitor does not displace the debtor, which continues to be in control of its property.

Court-appointed receiver. The BIA provides for the enforcement of security and the appointment of a receiver on a national basis over all or part of a debtor's property. A receiver has broad power to market and sell a debtor's assets with the oversight of the court. The receiver's duties include:

- giving notice of its appointment to all creditors;
- issuing reports on a regular basis outlining the status of the receivership; and
- preparing a final report and statement of receipts and disbursements when the appointment is completed or terminated.

Inspector. The role of inspectors is to oversee the bankruptcy and approve of certain actions, including the sale of most assets. Inspectors supervise the trustee on behalf of creditors, and instruct the trustee to act in a manner that is appropriate in order to protect the interests of creditors and the bankrupt estate.

9.2 Statutory Roles, Rights and Responsibilities of Officers

One of the hallmarks of Canadian bankruptcy and insolvency proceedings is the mandatory requirement that an LIT be involved in a supervisory or advisory role, depending on the proceedings.

LITs are insolvency specialists that are licensed by the OSB.

Trustees

Role

See **9.1 Types of Statutory Officers**.

Duties

As a court officer, the trustee must act fairly, equitably and impartially.

The BIA imposes numerous statutory duties on trustees, many of which are administrative in nature. The BIA also confers broad powers that a trustee can exercise with the permission of the inspectors appointed in the bankruptcy.

Receivers

Role

See **9.1 Types of Statutory Officers**.

Duties

A court-appointed receiver is not an agent of either the debtor or the security holder but, rather, an officer of the court, subject to the court's authority and direction and accountable to the court. A court-appointed receiver has a fiduciary duty to act in the best interest of all interested parties, including the debtor. A court-appointed receiver takes instruction from neither security holder nor debtor, and generally retains independent counsel.

A receiver must exercise prudence and reasonable care in the conduct of the receivership and in dealings with the receivership property.

The BIA imposes the following statutory duties on receivers:

- to disclose and account for their conduct of the receivership;
- to act honestly and in good faith; and
- to deal with the property of the debtor in a commercially reasonable manner.

CCAA-Monitor

Role

See **9.1 Types of Statutory Officers**.

Restrictions on who may be monitor

In addition to the requirement that the monitor must be an LIT, there are restrictions on who may act as monitor.

No trustee may be appointed as monitor if, within the last two years, the trustee was a director, officer or employee of the debtor, related to the debtor, or any director or officer of the debtor; or the auditor, accountant or legal counsel of the debtor.

Statutory duties

The monitor has many duties that are administrative in nature, such as publishing orders and reports and filing prescribed documents with the OSB.

The monitor has duties that are substantive in nature, such as reviewing the company's cash-flow statements filed with the court and commenting on them, advising on the reasonableness and fairness of a proposed plan, and reporting to the court on developments or changes in the proceeding.

The CCAA imposes an obligation on the monitor to act honestly and in good faith.

Obligations pursuant to court orders

The initial order and ensuing orders may require the monitor to perform additional obligations. For example, they may empower the monitor to monitor the debtor's receipts and disbursements, and assist the debtor in dealings with its creditors and in preparing the required cash-flow statements.

Proposal Trustee

Role

The role of a proposal trustee is similar to that of a monitor.

A proposal trustee is an independent third party appointed by the OSB to assist the company with the filing of its NOI or proposal and to monitor the company's ongoing operations during the proceedings. A proposal trustee must be an LIT. The debtor continues to be in possession of its assets; they do not vest in the proposal trustee.

Duties
Duties include monitoring the business's ongoing financial activities, reporting to the court on events that might affect the viability of the company, assisting the company in the preparation of its proposal, notifying the creditors of meetings of creditors and tabulating the votes at these meetings. The proposal trustee will also prepare a report on the proposal that is included in the mailing of the proposal to creditors.

Proposal trustees must report on the reasonability of the cash flows filed by the debtor on material adverse changes in the debtor's affairs and on any proposal presented by the debtor.

The proposal trustee must advise the court on the terms of the proposal and the conduct of the debtor. The proposal trustee's recommendation on the proposal will typically include a statement advising that the proposal offers more to a debtor's creditors than they would receive in a bankruptcy. If the proposal trustee cannot make this statement, it is likely that a court will refuse to approve the proposal.

9.3 Selection of Officers

The debtor will usually select court-appointed officers. If a creditor initiates the proceeding, that creditor will usually put forward its preferred officer. The appointment of a monitor or court-appointed receiver is not official until the court issues an order confirming the appointment.

Statutory officers are restructuring professionals with business and accounting qualifications who assist the debtor's employees in managing the operations during an insolvency proceeding as well as evaluating and making recommendations to the board of directors on restructuring alternatives available to the debtor. Trustees in bankruptcy and receivers displace the directors of the insolvent debtor in relation to dealings with the property, and may decide to continue to work with existing management. The debtor's employees are not employees of the court-appointed officers, though they work under their supervision and many of the decisions to be taken in a proceeding will require the court-appointed officer's consent.

Only an LIT may act as trustee, proposal trustee, monitor or court-appointed receiver.

10. Duties and Personal Liability of Directors and Officers of Financially Troubled Companies

10.1 Duties of Directors

Corporate directors in Canada are subject to statutory and common law duties. Two general obligations that are imposed on directors are:

- a fiduciary duty to act honestly, in good faith, and with a view to the best interests of the corporation; and
- a duty of care to exercise the care, diligence and skill of a reasonably prudent person in similar circumstances.

Corporate directors can attract personal liability under a number of provincial and federal statutes. For example, with respect to labour relations, personal liability is imposed on directors for unpaid wages, accrued vacation pay and, in certain cases, pension plan contributions that are due but unpaid.

Directors are personally liable for payroll remittances for amounts deducted from employees' wages on account of income taxes, contributions to the Canada (or Quebec, as applicable)

Pension Plan, and employment insurance premiums.

Directors will not be held personally liable for the above to the extent they can show that they were duly diligent, or that the failure to remit the amounts required in a timely manner was due to circumstances beyond their control.

Furthermore, directors may also be held personally liable for a corporation's default in payment of its goods and services tax or harmonised sales tax (HST) obligations.

Corporate directors may also be held personally liable if they are found to have acted improperly so as to cause a loss to the company's creditors.

10.2 Direct Fiduciary Breach Claims

In appropriate cases, court officers have been authorised to commence claims for breach of duties owed by shareholders and others to debtors and their stakeholders. These claims are based on the oppression and derivative action provisions of applicable corporate law statutes. The commencement of these claims generally requires leave of the court and evidence that it is more appropriate or practical for the court officer to bring the claims than creditors. Courts will also consider whether the commencement of these claims by a court officer will facilitate restructuring proceedings.

Assuming other applicable criteria are satisfied, creditors retain the ability to make claims for breach of duties owed by shareholders and others in respect of the debtor. Claims for breach of duty owed to debtors must either be brought by creditors or court officers, not both.

11. Transfers/Transactions That May Be Set Aside

11.1 Historical Transactions

Preference

A preferential transaction occurs where one creditor receives payment over another creditor before the initial bankruptcy event, or the date the CCAA proceedings were commenced, with the effect of the debtor preferring one creditor over another.

One of the following circumstances must exist:

- if the debtor and creditor are not related, the payment must have been made within three months of the initial bankruptcy event; or
- if the parties are related, the payment must have been made within 12 months of the initial bankruptcy event.

A preferential transaction is void and will be set aside by the court.

Transaction at Undervalue

A transaction at undervalue (TUV) occurs where the debtor was insolvent at the time the transaction occurred, or became insolvent as a result of the transaction, and the intent of the debtor was to defeat, delay or defraud its creditors.

For a transaction to constitute a TUV, it must have occurred:

- if the parties are not related, within one year of the commencement of the bankruptcy and while the debtor was insolvent, with intent to defeat creditors; or
- if the parties are related, within:
  - (a) one year of the commencement of the bankruptcy, without proof of insolvency at the time of the transaction and without

demonstrating intent to defeat creditors; or
(b) five years of the commencement of the bankruptcy if the debtor was insolvent at the time of the transaction or the transaction was intended to defeat creditors.

Where a TUV occurs, a court can set aside the transaction, or order the recipient of the payment to pay the difference between what it paid for the property and the actual fair market value of that property.

Improper Payments by the Bankrupt Corporation
Under the BIA, a court may inquire into whether the following payments made by a debtor were made at the time when the corporation was insolvent (or such payment rendered the corporation insolvent):

- the payment of a dividend (other than a stock dividend) or redemption or purchase for cancellation any of the shares of the capital stock of the corporation; and
- the payment of termination, severance or incentive pay, or other benefits to a director, officer or manager of the corporation.

If a court finds that such payments have been made improperly, judgment may be made against the directors of the debtor requiring repayment of such amounts.

These provisions place a reverse onus on the directors to prove that any of the aforementioned payments were:

- made in the ordinary course of business;
- not conspicuously over the fair market value of the consideration received by the corporation; and
- made at a time when the corporation was not insolvent, or that the transaction did not render the corporation insolvent (or that the directors had reasonable grounds to believe the foregoing).

Directors who objected to the corporation making payments of such benefits are exonerated from liability.

11.2 Look-Back Period
See **11.1 Historical Transactions**.

11.3 Claims to Set Aside or Annul Transactions
A trustee or monitor can initiate proceedings to challenge a transaction as a preference or TUV.

Provincial legislation permits creditors to seek to set aside preferences and transactions to defeat, delay or defraud creditors.

Contributed by: Cliff Prophet, David F.W. Cohen, Virginie Gauthier, Thomas Gertner and Kate Yurkovich,
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Gowling WLG is an international law firm built on the belief that the best way to serve its clients is to be in tune with their world, aligned with their opportunity and ambitious for their success. With more than 1,500 legal professionals in offices across Canada, the UK, Europe, the Middle East and Asia, the firm provides its clients with in-depth knowledge in key global sectors and a suite of legal services at home and abroad. Gowling WLG sees the world through its clients' eyes, and collaborates across countries, offices, service areas and sectors to help them succeed, no matter how challenging the circumstances.

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Trends and Developments

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Dealing With Distressed Condominium Development Projects

Author: David F.W. Cohen

It is no secret that one of the first segments of the Canadian economy to be impaired by inflation was the construction sector. Nowhere was this more obvious than in the condominium development industry. Which projects were in trouble depended on the timing of the development.

COVID-19 pandemic lockdowns began in Ontario (and across Canada) in mid-March 2020, straining the resources of developers and inevitably leading to significant and costly delays. Other consequences of the pandemic on the construction sector included the following.

- The municipal government approval process slowed to a snail's pace during the pandemic as staff worked from home.
- Construction sites were intermittently shut down following pandemic safety protocols.
- The global logistics crunch brought shipping to a grindingly slow pace, causing increased delays in the shipping of raw materials and finished products.
- The restricted shipping resulted in the cost of shipping increasing at an alarming rate.
- Raw materials and product pricing began to rise at alarming rates – including steel, timber and rubber.
- Subcontractors, rendered idle by the delays, began to walk away from contracts with the developers. These subcontractors were seeking better contract pricing with other projects or were renegotiating their pricing under an existing contract to account for inflation and the impact of the delays.
- Labour shortages started to hit home.

If a given project was pre-sold in 2018 and 2019 with construction commencing in late 2019 and early 2020, the pandemic was a perfect storm of delays, labour shortages and input cost escalation. Developers had pre-sold these projects into a hot condominium market at prices derived from 2018 and 2019 construction budgets. Condominium prices were continuing to climb even through the pandemic – at least while low interest rates held.

These developments were "out of the money". Indeed, if the developers completed the project they were destined to lose money – a lot of money. Yet market prices for condominiums continued to increase, or at least remained at all time high levels.

At the risk of oversimplifying what is a complex web of relationships, the stakeholders include:

- the developer;
- the construction manager;
- the sub-trades;
- the real estate broker;
- the secured construction lender;
- Condominium Escrow Deposit Bonds (surety bondholders);
- the unit buyers;

- Tarion (the quasi-government body protecting unit buyers); and
- excess deposit insurers.

Broadly speaking, a challenged developer had a few choices: (i) complete the project, close on the sale contracts with the unit buyers in accordance with their unit sale contracts, and take the loss; (ii) shut the project down and be in breach of contract with the unit buyers, potentially resulting in a bankruptcy; or (iii) file for creditor protection and make a proposal to the unit buyers. For restructuring professionals engaged by developers, it was this last alternative that was of greatest interest because it gave them an opportunity to reprice their project or convert it from a condominium project to a rental property project. One necessity was that the financially challenged project could not be co-mingled in the same corporate entity with financially healthy projects since one cannot selectively file only part of a business for protection or reorganisation.

There were a number of cases that ensued under the proposal provisions of the Bankruptcy and Insolvency Act (Canada) (BIA) or the Companies Creditors' Arrangement Act (Canada) (CCAA). The typical features of these cases included the following.

- The developer (likely a single-purpose company holding the financially challenged condominium project) would file for protection under the CCAA.
- The developer would stabilise the project by securing debtor-in-possession (DIP) financing which would normally not prime the position of the secured construction lender.
- The secured construction lender, which had likely frozen the pre-filing construction financing when the cost-to-complete budgets ballooned resulting in covenant breaches, would be stayed from taking enforcement steps. Since the new money was flowing in at a lower priority, as long as the project was being completed they were (sort of) happy. Their risk was the failure to complete construction and close on the unit sales.
- Sub-trades would not be compromised and the DIP loan would be used to keep the construction project running.
- A "representative counsel" for the unit buyers might be appointed by the developer to make negotiations with the unit buyers easier. Unit buyers could seek their own counsel rather than representative counsel, but they would have to fund that cost and opt out of the representative counsel order quickly.
- A plan would be presented to the unit buyers that would offer one or both of the following:
  - (a) unit buyers' deposits would be returned with a premium added to entice the unit buyers to take that option; and/or
  - (b) unit buyers would be able to purchase their unit at an amended higher price that gave the developer back its profit (or at least eliminated the developer's loss).
- In some instances, the developer would not provide the increased purchase price option since the developer wished to take the entire project as a rental property project and terminate the development as a condominium project. In that case, the unit buyers would only be offered the return of their deposit on a timely basis plus a likely larger premium to ensure the unit buyers supported the plan.

In most instances, a heated negotiation would occur between the developer and the unit buyers over the deposit premium and/or the unit purchase price increase. The developer might also agree to share profit with unit buyers above a certain level. The result has been that these

types of plans have been approved, and the projects completed and either sold at higher prices or converted to rental properties. The developers have avoided a loss (and potentially made a profit) and the unit buyers see their deposits returned with a premium or, in some cases, got to buy their unit, albeit at a higher price. The sub-trades, the real estate brokers, the secured construction lender, the DIP lender or the surety bondholder have suffered no losses.

It is worth noting that this restructuring solution only makes sense if the market price for the units has appreciated since the pre-sales were booked. If the market prices for the impaired condominium project have declined, it is more likely that a receivership model would be used, resulting in more of those stakeholders losing money. Unit buyers would not be interested in closing their transactions, making the economics of a restructuring undesirable. Indeed, if the market were to go upside down, the secured lenders might be rushing to complete the project and close the sales with the unit buyers (assuming the unit buyers do not default and walk away from their obligations) in order to avoid deeper losses.

As of the date of writing of this article, the condominium market in Ontario is showing softening as interest rates rise. The window may be closing on this solution for now.

Litigation Financing in the Context of Insolvency Matters

Authors: Geneviève Cloutier and Patrick Cajvan

Litigation financing is still in its early stages in the province of Quebec. The province has been reluctant to accept this method of financing. Recently, however, courts have seen this alternative funding model in a new light. In 2010, the Right Honourable Lord Rupert Jackson of the House of Lords conducted a comprehensive inquiry into the costs of civil litigation. In his report entitled Review of Civil Litigation Costs, Lord Jackson, among other things, refers to "third party financing" as a tool for access to justice. Litigation financing is now commonplace in the context of class actions in the province of Quebec as well as elsewhere in Canada. More recently, such agreements are spreading to commercial matters such as in insolvency matters.

The first major case in the context of a CCAA proceeding was that of Callidus Capital Corporation and Bluberi Group. The parties appealed to the Supreme Court, which notably decided that litigation funding can be approved as interim financing following a case-specific inquiry. To receive this approval, the litigation funding needs to further the preservation and realisation of the value of a debtor's assets. The litigation financing agreement must not contain terms that effectively convert it into a plan of arrangement.

The case of Fortress Global Enterprises Inc. also gained much attention in Quebec. Fortress operates a dissolving pulp business and renewable power co-generation facility in Thurso, Quebec. Two of Fortress's secured creditors initiated a CCAA proceeding. Litigation financing was sought by the debtor to pursue a CAD17 million claim the company had filed against a third party before the CCAA proceeding. The first judge refused to issue an order approving the litigation funding agreement since it allowed the litigation funder to terminate the litigation funding agreement in advance of an adverse costs award and did not ensure that eventual adverse costs would be honoured. A few weeks later, the parties sought once again the approval of the Court, which was yet again refused as the Court was not satisfied that the terms of the agree-

ment provided for a proper notice of termination of the agreement to the adverse party. As the CCAA process offers more flexibility and greater judicial discretion than the rules-based mechanism under the BIA, the Court remained open to further representations, which finally led to the approval of the litigation funding agreement with further amendments.

We do not yet know the place litigation financing will have in the Quebec legal system, but we see from recent case law that courts have embraced this means of financing.

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