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FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

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1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN CANADA

Welcome to **Module 4C**, dealing with the insolvency system of **Canada**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Canada's insolvency laws;
- a relatively detailed overview of Canada's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvency and how they are dealt with in the context of Canada.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST (GMT +1) on 31 July 2024**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2024 will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in Canada:

- the background and historical development of Canadian insolvency law;
- the various pieces of primary and secondary legislation governing Canadian insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;
- the rules of international insolvency law as they apply in Canada;
- the rules relating to the recognition of foreign judgments in Canada.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Canadian insolvency law; and
- be able to answer questions based on a set of facts relating to Canadian insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO CANADA

3.1 Canada – current society and historical roots

Canada is located in the northern part of North America. It extends from the Atlantic Ocean on its east coast to the Pacific Ocean on its west coast and northward to the Arctic Ocean. Canada covers 9.78 million square kilometres, making it the second largest country in the world by area. Much of this land area is wilderness and Canada has a relatively small, highly urbanized population of approximately 35 million people.[1] More than 80% of Canada's population live in large and medium-sized cities, mainly near the southern border with the United States.[2] Canada consistently ranks in the top 100 on the World Happiness Report,[3] is among the highest in international measurements of government transparency, civil liberties, quality of life, economic freedom and education and has the fifteenth-highest *per capita* nominal income globally.[4] It is one of the world's most ethnically diverse and multicultural nations as a result of large-scale immigration from many other countries and a pre-existing indigenous population (First Nations)**.**[5] Indigenous peoples in present-day Canada form 4.9% of the national population and include the First Nations, Inuit, and Métis; the last originating in the mid-17th century when First Nations and Inuit people married European settlers.[6]

Canada is divided into ten provinces (Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, Prince Edward Island, Saskatchewan and Quebec) and three territories (Northwest Territories, Nunavut and Yukon). Canada has two

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[1] "Canada Population 2018", *World Population Review*, online at worldpopulationreview.com/countries/canada-population/.

[2] "Provinces and Regions", *Statistics Canada*, online at https://www150.statcan.gc.ca/n1/pub/91-003-x/2007001/4129908-eng.htm.

[3] "World Happiness Report", by John Helliwell, Richard Layard and Jeffrey Scachs, online at https://s3.amazonaws.com/happiness-report/2018/WHR_web.pdf.

[4] "Canada Economics", *Trading Economics*, online at https://tradingeconomics.com/canada/gdp.

[5] "Aboriginal Peoples in Canada: First Nations People, Metis and Inuit", *Statistics Canada*, online at https://www12.statcan.gc.ca/nhs-enm/2011/as-sa/99-011-x/99-011-x2011001-eng.cfm.

[6] "Aboriginal Peoples in Canada: First Nations People, Metis and Inuit", *Statistics Canada*, online at https://www12.statcan.gc.ca/nhs-enm/2011/as-sa/99-011-x/99-011-x2011001-eng.cfm.

official languages: French and English. Quebec is the second-most populous province of Canada, after Ontario, and has a predominantly French-speaking population.[7]

Historically, Canada has strong ties to the United Kingdom (UK) and, to a lesser extent, France. The Dominion of Canada was created through the British North America Act of 1867. In 1982, the Constitution Act was signed, severing Canada's legal tie to the British crown.[8] Canada is a constitutional monarchy that is part of the Commonwealth with Her Majesty Queen Elizabeth II as the Queen of Canada and the titular Canadian head of state. However, under Canada's system of government, the power to govern on behalf of the people's interests is entrusted to the democratically-elected federal and provincial parliamentary governments.[9]

3.2 Economy

Canada is a developed country with a market-oriented economic system that has closely developed alongside its largest trading partner, the United States (US).[10] The 1989 Canada-US Free Trade Agreement and the 1994 North American Free Trade Agreement (which includes Mexico) has increased trade and economic integration between the US and Canada. Canada and the US enjoy the world's most comprehensive bilateral trade and investment relationship, with goods and services trade totaling more than $680 billion in 2017. Over three-quarters of Canada's exports are destined for the US each year.[11]

The Canadian economy is predominantly resource based, including a large oil and natural gas sector, with the majority of crude oil production derived from oil sands in the western provinces, especially Alberta. At present, Canada ranks third in the world in oil reserves and is the world's seventh largest oil producer.[12] Canada is the largest foreign supplier of energy to the US, including oil, natural gas and electric power, and a top source of US uranium imports.[13] The forest and mining industries are also a major source of economic activity. The majority of the lumber produced in Canada is exported to other countries, largely to the US.[14]

3.3 Legal system and government

Canada is a federal parliamentary democracy with three main levels of government, federal, provincial and municipal. The elected head of the federal government, known as the Prime Minister, is currently Justin Trudeau, the leader of the Liberal party. Each province and territory elects their own Premier. The main political parties that typically run in Canada's open and democratic elections are: the Conservative Party of Canada, the Liberal Party of Canada, the

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7 Land and Climate, Government of Canada, online at https://www.canada.ca/en/immigration-refugees-citizenship/services/new-immigrants/learn-about-canada/land-climate.html.

8 CIA World Factbook, online at https://www.cia.gov/library/publications/the-world-factbook/geos/ca.html.

9 Government, Government of Canada, online at https://www.canada.ca/en/immigration-refugees-citizenship/services/new-immigrants/learn-about-canada/governement.html.

10 CIA World Factbook, online at https://www.cia.gov/library/publications/the-world-factbook/geos/ca.html.

11 *Ibid*.

12 *Ibid*.

13 *Ibid*.

14 "Lumber and Wood Industries", Historica Canada, online at https://www.thecanadianencyclopedia.ca/en/article/lumber-and-wood-industries/.

New Democratic Party, the Bloc Quebecois, the Green Party, the Coalition Avenir Quebec and the Parti Quebecois.[15]

The legal system in Canada is a mix between common law and civil law, with all provinces and territories, with the exception of Quebec, adopting the common law system and Quebec adopting the French civil law system.

Legislative authority is delegated between the federal and provincial governments through the Constitution Act.[16] The federal government deals with areas of law listed in the Constitution Act that generally affect the whole country, such as national defense, foreign affairs, banking and bankruptcy and insolvency. The provincial and territorial level are responsible for areas such as education, health care, some natural resources, road regulations, securities and property and civil rights (which embraces all private law transactions, so virtually all commercial transactions).[17] Sometimes the province and territories share responsibilities with the federal government. For instance, health care is managed, organized and delivered by the provinces, but standards for quality of care are guided by the provisions of the federal Canada Health Act, which specifies the conditions and criteria the provincial and territorial health insurance programs must conform to in order to receive federal funding.[18] Municipal governments, based in cities, towns or districts, are responsible for local services such as libraries, parks, community water systems, local police, roadways and parking. They receive authority for these areas from the provincial governments. Across the country there are also elected band councils, which govern First Nations communities.[19] Understanding that there is a complex interplay between federal and provincial legislative authority is essential to understanding the nuances and development of Canada's insolvency law regime.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal system

Modern Canadian insolvency law is "fragmented" in that it does not issue from a single statutory source. The Constitution Act confers exclusive power to the federal government to make laws in relation to bankruptcy and insolvency.[20] Nevertheless, the provincial legislatures also exert influence over bankruptcy and insolvency through their authority in the realms of securities laws and property and civil rights (subject to the doctrine of "paramountcy", explained below). These federal and provincial statutory sources interact in complex ways with other sources of insolvency law; including procedural rules and regulations, directives and forms from the

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15 Canadian Political Parties, Canada Guide, online at http://www.thecanadaguide.com/government/political-parties/.

16 CIA World Factbook, online at https://www.cia.gov/library/publications/the-world-factbook/geos/ca.html.

17 "Our Country, Our Parliament", *Parliament of Canada*, online at https://lop.parl.ca/About/Parliament/Education/ourcountryourparliament/html_booklet/three-levels-government-e.html.

18 "Canada's Health Care System", *Government of Canada*, online at https://www.canada.ca/en/health-canada/services/canada-health-care-system.html.

19 "Our Country, Our Parliament", *Parliament of Canada*, online at https://lop.parl.ca/About/Parliament/Education/ourcountryourparliament/html_booklet/three-levels-government-e.html.

20 R J Wood, *Bankruptcy and Insolvency Law*, (2nd Ed, Irwin Law), "Essentials of Law", p 1 (hereinafter referred to as Wood).

insolvency regulator, judicial interpretation of statutes, common law legal precedent and the exercise of situational judicial discretion.[21]

The origins, growth and development of modern Canadian insolvency law can be traced through a series of statutes dating back to confederation. The first insolvency statute was the Insolvent Act which was enacted in 1869 and succeeded by the Insolvent Act of 1875. The 1875 Act was repealed in 1880 and not replaced until the enactment of the Bankruptcy Act, RCS in 1919.[22] A re-enactment was effected in 1949 and the current Bankruptcy and Insolvency Act, RSC 1985, c B-3 (BIA) compromises parts of the 1949 amendment, with important amendments occurring in 1992, 1997 and 2009.[23] The Companies Creditors Arrangement Act (CCAA),[24] was enacted in 1933 but its use fell away until the mid-1980s when it became a preferred vehicle by the courts for large-scale commercial restructuring.[25]

4.1.1 Sources of Canadian insolvency law

An important distinction to keep in mind is that in Canada "bankruptcy" is a legal status that can be applied to both individuals and legal entities, while "insolvency" is a financial condition. In bankruptcy an entity's assets "vest" in a trustee, meaning they lose legal entitlement to deal with them, and the trustee liquidates the assets and distributes the proceeds to creditors in accordance with the priority of claims. Insolvency, on the other hand, is the financial state of being unable to meet one's debts as they fall due (cash-flow test) or having liabilities that exceed the value of the assets (balance sheet test).

Insolvent parties may become subject to a number of different formal and informal proceedings, bankruptcy proceedings being only one such form.[26] The most common forms of insolvency proceedings are: (i) BIA[27] liquidations, (ii) BIA reorganizations, (iii) CCAA[28] reorganizations, and (iv) court-appointed or private receiverships.

There are two features common to all formal insolvency proceedings in Canada: (i) they follow the "single-proceeding" model, and (ii) they take a "universalist" approach in that they purport to affect a debtor's assets wherever located.[29] As will be seen, Canada has embraced "modified universalism" in its approach to cross-border insolvency issues.

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21 *Ibid*.
22 A Duggan *et al*, *Canadian Bankruptcy and Insolvency Law* (3rd Ed, Emond Publishing), p 2 (hereinafter referred to as Duggan *et al*).
23 *Ibid*.
24 [1985] Ch 36.
25 Duggan *et al*, *supra* note 22, p 2.
26 L A Rogers and P L J Huff, "Commercial Restructuring and Insolvency in Canada", The Insolvency Law Institute, pp 1-2 (hereinafter referred to as Rogers and Huff).
27 [1985] Ch B-3.
28 [1985] Ch 36.
29 Duggan *et al*, *supra* note 22, pp 2-3.

4.1.2 Federal statutes

The main federal statutes governing insolvency proceedings are:

- The BIA, which sets out Canada's bankruptcy regime for both individuals and for the liquidation of a business. The BIA also includes provisions governing debtor in possession "proposals", a restructuring process that allow debtor companies to reach compromises with their creditors, including the sale of all or part of the business, under court supervision. The proposal process is generally used for smaller companies with less complex restructuring needs.

- The CCAA, a debtor-in-possession restructuring statute that sets out a relatively skeletal framework for the reorganization of insolvent companies with debts over CAD 5 million and follows many of the same concepts as a US Chapter 11 procedure (although there are important technical differences). The CCAA provides for "plans of arrangement" so debtors can reach compromises with their creditors. The CCAA also allows for the sale of all or part of the business under court supervision, even without a formal plan of reorganization. The CCAA is generally the vehicle used for complex restructurings of large businesses.

- The Winding-up and Restructuring Act,[30] which is primarily used to wind up specific federally regulated bodies that are exempted from the BIA and CCAA, for example, banks, insurance companies or trust corporations.

- The "plan of arrangement" provisions of the Canada Business Corporations Act (CBCA)[31] may also be used where complex or fundamental changes are made to shareholdings or the debt structures of federally registered companies (as opposed to operational restructurings). As discussed further herein, the use of the CBCA arrangement provisions is an increasingly popular means of facilitating corporate debt restructurings and recapitalizations as, among other things, it can be less court intensive and more cost efficient compared to a CCAA restructuring and it also avoids the stigma of taking steps under an insolvency-specific statute.

Aside from the monetary threshold to enter proceedings, the primary differences between a restructuring under the BIA and one under the CCAA is that the former has more procedural steps and strict timeframes, rules and guidelines, while the latter is more discretionary and judicially-driven. The BIA has 285 sections. The CCAA contains a total of 63. Cost may also be a factor. CCAA proceedings are court intensive. They often involve more professionals and more court attendances and have resultantly higher costs.

[30] [1985] C W-11.
[31] Canada Business Corporations Act, RSC 1985, c B-44.

4.1.3 Provincial statutes

The main provincial statutes affecting insolvency proceedings are:

- the individual Personal Property Security Act (PPSA) of each province and territory, which regulate the creation and registration of security interests in personal property. These statutes are modelled on the US Uniform Commercial Codes. Quebec has its own Civil Code analogue.

- the Courts of Justice Act, Judicature Act and the Rules of Civil Procedure of each province and territory, which govern the procedural rules followed by the court during an insolvency proceeding, but also authorize courts to grant substantive relief such as appointing receivers, or issuing injunctions to preserve assets or prescribe behaviour.

- provisions of the provincial corporations Acts (also contained in the federal CBCA) that allow companies in BIA or CCAA restructuring proceedings to complete "reorganizations" of their share capital without shareholder approval. Such corporate reorganizations can include amalgamations, liquidations, dissolutions or a combination of any of these.

4.1.4 Paramountcy

Provided there is not a conflict between the operation of provincial law and the federal law, both apply and may interact or inform one another. The constitutional principle of federal paramountcy provides that valid provincial legislation will be rendered inoperative where: (1) there is an operational conflict with federal law such that it is impossible to comply with both laws, or (2) operation of the provincial law frustrates the purpose of the federal law. The principle is easy to state, but hard to apply. What constitutes an "operational conflict" between federal and provincial statutes or "frustrates the purpose of federal law" continues to be wrestled with by courts and practitioners.

4.1.5 Receiverships

Insolvency proceedings may also take the form of private, or more commonly, court appointed receivers. Receivership law developed as a form of equitable relief under the common law, but many of the common law developments are now enshrined in the BIA and the various provincial Courts of Justice Acts. A receiver is a licensed trustee in bankruptcy – typically a licensed professional in an accounting or financial advisory firm. The receiver, by way of court order pursuant to a security agreement, can be granted the right to take possession of, and sell, the assets subject to the receivership. A receiver may also be appointed by a court for other reasons, including managing a business for a period, or conducting an investigation of certain affairs. Receivers may be appointed under either the BIA by a secured creditor, with national power and authority, or by any interested party under the Courts of Justice Acts of the provinces and territories (with the exception of Quebec), which allow the court to appoint a receiver and / or receiver and manager when it is "just or convenient" to do so. The BIA also provides for the

appointment of an "interim" receiver to protect and preserve assets on a temporary basis in certain circumstances.[32]

4.1.6 Other sources of insolvency law

As noted above, the framework for Canada's modern insolvency system is based in statute, but there is significant interplay between the various statutes and other sources of insolvency law, such as statute specific procedural rules, rules of court, Superintendent's Directives and Forms, and the common law derived from custom and judicial precedent.

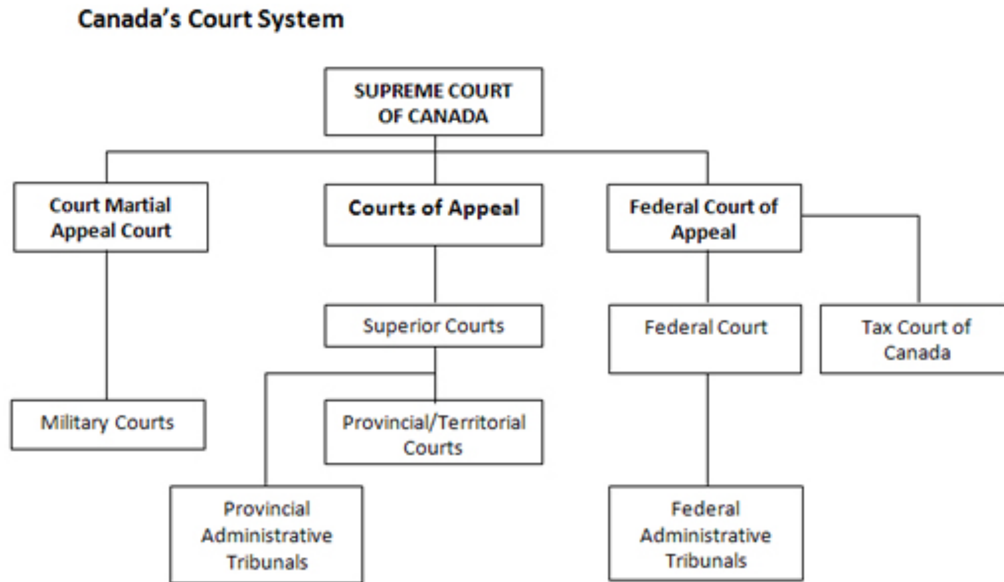
For instance, the Bankruptcy and Insolvency General Rules under the BIA are a series of procedural rules that govern aspects of how the court deals with bankruptcy applications, as well as providing for rules governing proposals, mediations and a code of ethics for trustees.[33] The BIA also vests authority in the Superintendent of Bankruptcy to issue directives in order to carry out the purposes and provisions of the BIA.

Judges ultimately interpret the statutes and rely on legal precedent (that is, influential past judgments) in doing so. The exercise of judicial discretion embodied in the common law has been the greatest driver of the evolution of the modern Canadian insolvency regime. Canadian judges in the common law provinces have "inherent" jurisdiction to fill in gaps in legislation and create remedies where a particular statute or rule does not specifically provide for one, but the circumstances and policy imperatives of the legislation call for one.[34] The Canadian insolvency regime has therefore evolved through case law and practice, which has been subsequently codified in statutory amendments, such as with DIP financing, disclaimer and assignment of contracts and critical supplier charges. While Canada's insolvency legislation follows many of the same concepts as US Chapter 11, it is arguably more flexible than the US Code and practice because of the discretion afforded to judges.

[32] Rogers and Huff, *supra* note 26, p 19.
[33] Wood, *supra* note 20, p 12.
[34] I H Jacob, "The Inherent Jurisdiction of the Court", *Current Legal Problems*, Vol 23, Issue 1, 1970, p 51.

4.2 Institutional framework

4.2.1 Overview of court system



Source[35]

Canada's court system is generally perceived to be fair, efficient and balanced in relation to the enforcement of debtor and creditor rights, within the context of an overall insolvency scheme that favours debtor rehabilitation. The court system is governed by the open court principle, which requires that court proceedings presumptively be open and accessible to the public and to the media.

The Supreme Court of Canada (or SCC) is the highest court in Canada and is based in the city of Ottawa, the capital of Canada, located in the province of Ontario.[36] The Supreme Court is comprised of 9 judges, appointed by the federal government for a life appointment, who have the power to review lower-court rulings on any legal issue and interpret the compliance of both federal and provincial legislation with the Constitution of Canada. The Supreme Court generally limits its docket to around 100 cases per year, and only to those which involve issues of national importance.[37] As a practical matter, the Supreme Court rarely takes up commercial cases and even more rarely engages in an analysis of insolvency issues. As a result, the interpretation of insolvency law primarily takes place at the provincial superior court and the provincial appeal court level.

Each province and territory has its own Superior Court system. There are two levels, one to hear trials and the other to hear appeals. The Federal Court and the Federal Court of Appeal handle

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35 http://www.gridgit.com/postpic/2009/11/ontario-court-system_338551.jpg.

36 "Structure of the Courts", Canadian Superior Courts Judges Association, online at http://www.cscja-acjcs.ca/structure_of_courts-en.asp?l=4.

37 *Ibid.*

issues that arise under federal laws (with the exception of bankruptcy) and appeals from decisions of federal administrative tribunals.

The provinces and territories appoint their own judges, and these courts have the power to deal with every criminal offence, except certain criminal offences such as murder. They also handle violations of provincial laws. Provinces and territories have also established small claims courts to resolve civil actions involving amounts of money under CAD 25,000.[38] The small claims court provides for an expedited procedure in order to deal with claims of low monetary value.

4.2.2 Bankruptcy court in Canada

Canada does not have a dedicated federal bankruptcy court. Instead, the BIA and the CCAA assign jurisdiction to the provincial and territorial courts. Jurisdictions with large urban centers that often hear a greater number of insolvency proceedings have established specialized branches of the provincial court to hear commercial matters, including insolvency issues. For example, Toronto has established the Commercial List and Montreal has established the Commercial Division. These commercial courts function effectively and efficiently due to their streamlined mandate and the appointment of judges with particular experience in commercial matters.[39]

A provincial or territorial court that exercises jurisdiction in bankruptcy is commonly referred to as a bankruptcy court.[40] The bankruptcy court has many different functions with respect to insolvency proceedings. For example, in involuntary bankruptcy proceedings under the BIA the court assesses the sufficiency of the evidence supporting the filing by creditors against the debtor and makes an order assigning the debtor into bankruptcy if the evidence supports the contention that the debtor has committed an act of bankruptcy in accordance with the statutory definition. A bankruptcy court may also provide directions to the trustee in bankruptcy if the trustee is uncertain on how certain assets should be handled or how certain issues should be addressed.[41] The bankruptcy court approves proposals or plans under either the BIA or the CCAA before they may be implemented. The bankruptcy court has overall supervisory authority and many interim functions before a final order is given in an insolvency proceeding, such as the ability to determine disputed priority rights between creditors, grant and / or continue stays of proceedings, determine the valuation of creditor claims and approve DIP financing, among other things.

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[38] *Ibid.*
[39] *Ibid.*
[40] Wood, *supra* note 20, p 47.
[41] *Ibid.*

4.2.3 Enforcement system: creditor rights

4.2.3.1 Inside insolvency proceedings

All Canadian insolvency processes provide for a single, collective proceeding that supersedes the usual processes available to creditors to enforce their claims. Creditors' remedies are collectivized in a single proceeding to avoid the social and economic costs of a chaotic free-for-all where creditors are incentivized to enforce their rights to seize assets before other creditors do.[42]

Secured creditors are not affected by a liquidating bankruptcy and generally may enforce their security, subject to certain limitations discussed in more detail below. Secured assets are therefore not included in the pool of assets under the control of the trustee, except to the extent that there is equity in the assets. A secured creditor may elect to participate in the bankruptcy as an unsecured creditor to the extent its claim is not fully secured.

In CCAA proceedings, secured creditors are generally stayed from enforcing their security. In BIA proposal proceedings, secured creditors are initially stayed, but if the debtor chooses to make a proposal only to unsecured creditors, then the stay is lifted with respect to secured creditors.

In a liquidating bankruptcy, the distribution of assets and personal property is controlled by the trustee in bankruptcy in accordance with the statutory distribution scheme. In CCAA proceedings distributions are generally overseen by a court officer called a "monitor". In receiverships, the receiver. All such estate professionals are licensed insolvency professionals, generally from accounting or financial advisory firms, and are officers of the court responsible for acting in a fair and transparent manner and in the best interests of all stakeholders.[43]

4.2.3.2 Outside of insolvency proceedings

Outside of a formal insolvency process, creditors have various ways to enforce their claims against debtors.

Secured creditors may enforce and realize their security interest in the collateral covered by their security in accordance with the terms of their security agreement. When enforcing its security, a secured party must comply with applicable federal and provincial laws, including serving statutory notices. For instance, section 244 of the BIA requires that a secured creditor send a prescribed "notice of intention" to enforce security to the debtor where the second creditor intends to enforce on "all or substantially all" of the property of the debtor, which gives the debtor 10 days to effect payment.

Unsecured creditors generally must bring a civil action to obtain a judgment against the debtor and then execute on that judgment in order to make recovery on their claims against the debtor.

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[42] *Idem*, pp 2-3.

[43] G Dabbs, "Bankruptcy and Creditors' Rights", online at http://www.gdlaw.ca/blog/2017/05/bankruptcy-and-creditors-rights.shtml?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original.

Where a creditor can substantiate concerns that assets may be depleted or absconded with, they may also be able to obtain one of several types of injunctive orders that have the effect of freezing personal or real property pending a court hearing on the creditor's claims against the property. Under certain statutes there are provisions that allow a particular type of unsecured creditor to put a lien on the property of the debtor for particular types of claims, such as under the Builders' Lien Act.[44] When the debtor's property is sold, the creditor can receive proceeds from the sale in the amount of the lien.

Creditors also have rights through the provincial Fraudulent Conveyances (FCA) and / or Assignments and Preferences Acts (APA),[45] by which transfers of assets by a debtor with the intent of avoiding payment to a creditor are deemed void. Where a plaintiff establishes that a conveyance was made with "fraudulent intent" and without good consideration, the conveyance may be set aside. Similarly, any payment by a person who is insolvent or near insolvent, with the intent of giving a preference to one creditor over the others, is void under the various APAs.

Canada also has a broad, discretionary corporate legal remedy known as the "oppression remedy". The oppression remedy is legislated both federally, under the Canada Business Corporation Act[46] in section 241 and provincially under each Province's Corporations Act. Oppression may be claimed against a corporation by any stakeholder for a vast range of unfair conduct. Stakeholders can include shareholders, directors, officers and both secured and unsecured creditors. When stakeholders believe the corporation is acting or has acted in a way that unfairly undermines or prejudices their legitimate expectations, they may assert their claim in court. If the stakeholder successfully proves their claim, the court has broad remedial powers to ensure the affected party has access to an appropriate remedy. In the case of creditors, the remedy may include a return of the value of their investment.

Inside of insolvency proceedings, the oppression remedy may be exercised by an estate professional such as a trustee, monitor or receiver. The professional may choose to assert an oppression action in order to unwind a pre-proceeding transaction which it believes is unfairly prejudicial to the debtor corporation's stakeholders. Since the oppression remedy gives the court broad remedial powers to "cure" the oppression, the court has the ability to unwind the transaction to place the debtor corporation back into their position before the oppressive transaction occurred.

4.2.4 Insolvency regulator: Office of the Superintendent of Bankruptcy

Proceedings under the CCAA and BIA are subject to the administrative oversight (as opposed to direct daily involvement) of the federal government office known as the Office of the Superintendent of Bankruptcy (the OSB). The federal government also appoints Official Receivers to carry out statutory administrative duties in each bankruptcy jurisdiction across Canada. The Official Receivers report to the OSB.

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[44] See eg British Columbia's Builders' Lien Act [1997], C 45.

[45] See eg Ontario's Fraudulent Conveyances Act, RSO 1990, c F.29 and Assignments and Preferences Act, RSO 1990, c A.33.

[46] [1985] Ch 44.

The role of the Office of the OSB is to ensure bankruptcies and insolvencies are handled as fairly and efficiently as possible. The OSB is responsible for administratively supervising all estates and matters to which the BIA applies, as well as select matters under the CCAA.[47] The position has a number of functions which include regulating the insolvency profession and ensuring compliance through maintenance and enforcement of the regulatory framework.[48] This includes: (i) licensing and supervising of trustees, (ii) inspecting or investigating estates, (iii) receiving and dealing with complaints from creditors against estate professionals during proceedings, (iv) examining a trustee's account of a bankruptcy and ensuring all the correct information is accounted for, and (v) maintaining public records regarding the filing of proposals, bankruptcies, license issues and appointments of receivers under the BIA.

Self-Assessment Exercise 1

Question 1

What remedies are available to an unsecured creditor to enforce their rights outside of a formal insolvency process?

Question 2

What formal restructuring remedies are available for corporations under Canadian law and why might a debtor company choose one over another?

Question 3

How might a provincial law that conflicted with a federal law that affects rights and obligations in an insolvency scenario be treated under Canadian constitutional principles?

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

5.1 Immovable (real) property

Lenders can take a security interest in immovable property such as lands or structures (called "real property"), by obtaining a mortgage or "charge" on land or a debenture from the borrower, known in Québec as an "immovable hypothec". The security interest is registered against title to the property in the Land Registry Office where the property is located. Where rents are

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[47] Office of the Superintendent of Bankruptcy *Canada,* Government of Canada, online at https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br01852.html.

[48] *Ibid.*

included in the collateral, an assignment of leases and rents can also be registered on title as collateral security.[49]

The registration of a security interest does not result in the transfer of the land or an interest in the land and is discharged on payment of the principal, interest and other amounts owing on the loan in accordance with the governing document.[50]

On default, the secured party can usually elect between selling the property and claiming any deficiency in the amount owing from the debtor, or foreclosing and obtaining title in court proceedings to retain the property as its own, in which case its claims against the owner are extinguished.[51]

5.2 Movable (personal) property

The creation of security interests in movable property (called "personal property") is governed by the PPSA of a particular jurisdiction. In Quebec, the corresponding personal property legislation is found in the Civil Code.[52]

The general purpose of PPSAs across Canada is to allow lenders to establish a transparent security registration regime that establishes priority between creditors in order of registration. Security under a PPSA is available through contract over personal property. "Personal property" is broadly defined and includes chattel paper, documents of title, goods, instruments, intangibles, money and investment property.[53] "Intangibles" captures intellectual property rights such as patents, trademarks and copyrights. "Investment property" includes securities, security entitlements, security accounts, futures contracts and futures accounts.

Under the PPSAs a security interest is not valid and enforceable against a third party unless two requirements have been met: (i) the security interest has "attached" to the collateral, and (ii) the security interest has been "perfected". For attachment to occur, value must be given by the secured party, the debtor must have rights in the collateral, and the debtor must sign a security agreement that describes the collateral sufficiently to enable it to be identified, or the secured party must have possession or control of the collateral. Perfection is achieved through registration by filing a PPSA "financing statement" or by possession or control of the collateral. "Control" occurs when the collateral can be sold by a secured party without any further action by the debtor.

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[49] See eg the Ontario Land Titles Act RSO [1990], c L.5, s 93.

[50] See eg *idem*, c L.5, s 93(3).

[51] See eg the Ontario Mortgages Act RSO [1990], c M.40, Pt III and Pt IV.

[52] Relevant PPSA legislation across Canada: Personal Property Security Act RSBC [1996], c 359 (British Columbia); Personal Property Security Act TSA [2000], c P-7 (Alberta); Personal Property Security Act SS [1993], c P-6.2 (Saskatchewan); Personal Property Security Act CCSM [1993], c P35 (Manitoba); Personal Property Security Act RSO [1990], c P.10 (Ontario); Personal Property Security Act SNB [1993], c P-7.1 (New Brunswick); Personal Property Security Act SNS [1995-96], c 13 (Nova Scotia); Personal Property Security *Act* SPEI [1997], c 33 (Prince Edward Island); Personal Property Security Act SNL [1998], c P-7.1 (Newfoundland and Labrador); Personal Property Security Act RSY [2002], c 169 (Yukon); Personal Property Security Act SNWT [1998], c 8 (Northwest Territories and Nunavut).

[53] See, eg, Personal Property Security Act RSO [1990], c P.10, s 2.

A secured party may take a security interest in some or all of the debtor's property. An interest in all of the debtor's property usually comprises "all present and after acquired property", which allows the secured creditor to attach its interest to all property existing at the date of registration and afterwards acquired, without the need to specifically identify specific assets or classes of assets.[54]

Once a creditor obtains an interest in collateral, they must register their interest to maintain their priority over secured assets not in their possession and control. Each province has a central registry where creditors can register their security interest by filing a "financing statement". This system allows for other potential creditors to search the registry and understand what previously registered security interests stand in priority to any security they may seek to register.

A security interest that is perfected as at the date a debtor commences insolvency proceedings will be effective against all the other creditors of the debtor. On the other hand, an unperfected security interest will not be effective in an insolvency and the creditor will rank as an unsecured creditor (except in relation to secured assets that can be perfected by possession or control).

General priority rules between secured creditors under the PPSAs are based on first-in-time registration, although there are special priority rules that relate to "super-priorities" for deemed trusts under taxation laws, landlord's right of distress, etc. These may vary depending on the type of insolvency proceeding, as discussed below.

5.3 Insolvency proceedings: enforcement of security interest

A secured creditor's enforcement remedies against collateral are not regulated by the liquidating provisions of the BIA and are not subject to the automatic stay of proceedings that occurs when a company or individual is assigned into bankruptcy.[55] Proceeds from secured collateral not in the possession or control of the secured creditor are not used to satisfy all of the creditors, but instead are used to first fully satisfy the obligation owed to the secured creditor. If there is a surplus from the sale of collateral exceeding the secured creditor's interest, the trustee is entitled to the surplus to distribute among the remaining creditors. A secured creditor has the right to assert an unsecured claim in the bankruptcy for the balance of its claim if the collateral pertaining to their security interest does not satisfy their secured obligation.[56]

A bankruptcy may, however, affect the rights of the secured creditor to the extent necessary to allow the trustee to realize on any surplus value in the collateral. The trustee can require the secured creditor to prove its security; cause the secured creditor to value its security; inspect the collateral subject to the security to value it; and redeem the collateral subject to the security by paying the secured creditor the amount of the assessed value of the security, upon which redemption the collateral becomes an asset of the bankruptcy estate. In addition, in rare circumstances the court may make an order staying a secured creditor from realizing on its security, but the maximum period of such stay is six months. Such stay orders are not commonly

54 B Macdougall, *Canadian Personal Property Security Law*, (2nd ed, LexisNexis, 2014), §4-006 (hereinafter referred to as Macdougall).

55 BIA, s 69.3(2).

56 Wood, *supra* note 20, p 131.

granted; they may, however, be made in situations where the trustee requires time to value the collateral and determine if it should exercise its right of redemption.[57]

By contrast, in CCAA proceedings, secured creditors are generally stayed from enforcing their security. In BIA Proposal proceedings, secured creditors are initially stayed, but if the debtor chooses to make a proposal only to unsecured creditors, then the stay is lifted with respect to secured creditors. The policy rationale for this distinction arises from the differing purposes of the regimes: liquidation versus restructuring.

5.4 Outside of an insolvency process: Enforcement of a security interest

Outside of a formal insolvency process, a secured party may enforce their interest in collateral on an event of default by the debtor under the security agreement. What constitutes an event of default is largely based on what the creditor and debtor decide in the contractual agreement.[58] An event of default is defined in the PPSAs as failure to pay or perform an obligation secured when due or the occurrence of event that, pursuant to the terms of the contract, causes the interest to become enforceable.[59] In the event of default, the secured creditor has the rights available to them under the security agreement. Under the majority of provincial PPSAs the secured party also has the right to proceed directly against the collateral the secured party has an interest in and take control and possession of the collateral or of the proceeds through the proper legal channels, which may often be through a private or court-appointed receiver.[60]

Self-Assessment Exercise 2

Question 1

Are a secured creditor’s rights regulated by the liquidating bankruptcy process, and if so, how?

Question 2

Provide an example of a situation where a secured creditor would choose to enforce their rights as a creditor within the bankruptcy process.

Question 3

What are the consequences of failing to attach or perfect a security interest?

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[57] Rogers and Huff, *supra* note 26, p 16.
[58] Macdougall, *supra* note 54, §10-005.
[59] *Idem*, p 416.
[60] *Ibid*.

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

6.1.1 Policy goals

Canada's insolvency regime aspires to strike a balance between reorganization and liquidation. The policy rationales that underlie the Canadian insolvency system focus on certainty, transparency, asset preservation, value maximization and rehabilitation. [61] Where appropriate, the Canadian insolvency system provides for, and favours, debtor rehabilitation because of the perceived social benefits that flow from the rehabilitation of debtors. These include increased recoveries for creditors, the maintenance of supplier relationships and local economic activity, and the preservation of jobs.[62] At the same time, Canada's insolvency framework recognizes existing creditor rights and establishes clear rules for the ranking of priority claims and the equitable treatment of similarly situated creditors. This balanced approach flows from the recognition that certain and reliable rules provide security for investors and lenders that, in turn, influences the cost and availability of credit in the Canadian marketplace.[63]

6.1.2 Management of proceedings

These policy concerns are reflected in the way insolvency proceedings are managed through a combination of creditor control, estate professional management and court supervision that includes consideration of the interests of the debtor and other stakeholders (including employees, the community, customers, etc). The overall regulation and management of insolvency proceedings is primarily done through the oversight of the court. The day-to-day process is largely overseen by court appointed representatives such as trustees, receivers or the CCAA monitor, who owe broad duties to the court and all stakeholders and periodically report to creditors and the court. Creditors are provided a degree of control over insolvency proceedings through voting mechanisms and other powers in both bankruptcy and restructuring situations and may seek to replace estate professionals in certain circumstances. Creditors also have the right to information and to be heard by the court overseeing the insolvency proceeding.

BIA liquidating bankruptcy proceedings are managed by a trustee. The trustee must seek court approval when taking certain steps, such as selling the debtor's property and finalizing its discharge. BIA proposal proceedings are debtor-in-possession, but a proposal trustee manages the process. Any proposal approved by the debtor's creditors must also be approved by the court. CCAA proceedings are also debtor-in-possession, but are predominately court driven. A

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[61] https://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00882.html.

[62] *Ibid.*

[63] *Ibid.*

monitor is appointed by the court to oversee the process on its behalf and any plan of arrangement approved by the creditors of the debtor must also be approved by the court. A restructuring under a corporate statute such as the CBCA is managed by the corporation, but the court typically establishes the process for presenting the arrangement to the company's stakeholders and, once approved by the stakeholders, the arrangement must be approved by the court. In a court-ordered receivership the receiver obtains its powers from the appointing order and periodically reports to the court to seek approval of its activities, including the approval of sales processes, the acceptance of bids and approval of major asset sales, as well as distributions to creditors.

Unsecured creditors direct the administration of the estate in a liquidating bankruptcy. Significant creditors or creditor groups will often be actively involved in restructurings under the CCAA or BIA both in the pre-filing and post-filing stage and can exert a degree of influence commensurate with the value and priority of their claims. For instance, creditors may either individually or collectively hold sufficient debt of a class of creditors (33 1/3% of the debt) that allows them to effectively "block" approval of any CCAA plan or BIA proposal. This is a particularly acute issue in Canada because unlike the US there are no "cram down" provisions that allow for the imposition of a plan by a court despite any objections by certain classes of creditors. Unions, pensioners, retirees and other employee groups may also have a significant impact on a restructuring on account of the size of their numbers, the different impact an insolvency has on their interests versus purely "financial" creditors and the resultant sensitivity that the public and courts generally have to their interests.

6.2 Corporate and personal bankruptcy

While in the UK and other jurisdictions "bankruptcy" is a term applicable only to individuals and corporations that are "liquidated", in Canada, both natural persons and legal entities are subject to bankruptcy proceedings. The BIA contains a comprehensive code for the orderly liquidation of a bankrupt's estate and the distribution of the value of the assets in that estate to the bankrupt's creditors. The recognized purposes of the BIA include:

(a) providing for the financial rehabilitation of insolvent persons;

(b) providing a collective proceeding for orderly and fair distribution of property of a bankrupt among unsecured creditors on a *pari passu* basis;

(c) allowing for an investigation to be made into the affairs of a bankrupt; and

(d) setting aside transfers under value, preferences, settlements and other fraudulent transactions so all creditors may share equally in the value of the bankrupt's assets.[64]

[64] The Hon Mr Justice Lloyd Houlden, Mr Justice Geoffrey B Morawetz and Dr Jannis P Sarra, "The 2022-2023 Annotated Bankruptcy and Insolvency Act" at §1:4 (hereinafter referred to as Houlden and Morawetz).

Broadly speaking, the BIA operates in a similar way for both companies and individuals, with specific, technical differences. Some of the key differences between the corporate liquidation regime of the BIA and the personal regime include:

- the "summary administration", "consumer proposal" and "orderly payment of debt" processes discussed below are only available to individuals;
- certain property of individuals is exempt from seizure under provincial legislation and thus exempt from distribution to creditors. This is not the case with corporations; and
- individual bankrupts are entitled to keep a portion of income earned to maintain a reasonable standard of living, in accordance with standards set by the Superintendent of Bankruptcy. Any income in surplus of such standard must be paid to the trustee. Again, this is not the case with corporations.

Due to the similarity of operation of the key provisions of the BIA with regard to both corporations and individuals, this section will discuss them together and note other, significant differences between corporate and individual bankruptcy as appropriate.

6.2.1 Definition of "debtor"

The definition of "debtor" in section 2 of the BIA includes an "insolvent person" and any person who, **at the time** an "act of bankruptcy" was committed by him, resided or carried on business in Canada.

A "person" includes a partnership, an unincorporated association, a corporation, a cooperative society or a cooperative organization, as well as the successors, heirs, executors, liquidators of the succession, administrators or other legal representatives of a person.

An "insolvent person" means a person who is not bankrupt, resides or carries on business or has property in Canada, and whose liabilities to creditors provable as claims under the BIA amount to at least CAD 1,000, and (a) is unable to meet obligations as they generally become due (the cash flow test), (b) has ceased paying current obligations in the ordinary course of business as they generally become due, or (c) the aggregate of whose property is not, at fair valuation, sufficient to enable payment of all of his obligations, due and accruing due (the balance sheet test).

The definition of "corporation" includes a company or legal person that is incorporated by or under an Act of Parliament or of the legislature of a province, an incorporated company, wherever incorporated, that is authorized to carry on business in Canada or has an office or property in Canada or an income trust. This means that the BIA is broad enough to support a filing by a foreign-registered company with assets or property in Canada, although principles of COMI may come into play if the appropriateness of the filing is challenged.

6.2.2 System for entering bankruptcy

There are three methods for entering into bankruptcy:

(1) involuntary;

(2) voluntary; and

(3) on the failure of, or failure to perform the terms of, a BIA proposal.[65]

6.2.2.1 Involuntary bankruptcy

To successfully make out an application for an involuntary bankruptcy order, the applying creditor(s) must (i) be owed in excess of CAD 1,000 of unsecured debt and (ii) provide evidence that the debtor has committed an "act of bankruptcy" within six months of the date of the filing of the application.[66] The use of the words "at the time" in the definition of "debtor" means that the creditor need not prove the debtor currently carries on business or resides in Canada, or currently has assets in Canada. An involuntary bankruptcy application must be brought to the bankruptcy court in the location where the debtor ordinarily resides, does business, has assets or property, or in the case where the debtor has no assets currently in Canada, where it did business within the previous year.

An "act of bankruptcy" essentially involves one of two different types of conduct. One is conduct that shows that the debtor violated certain norms of commercial morality by attempting to frustrate the legitimate collection efforts of the creditor.[67] The other is conduct that shows the debtor is insolvent.[68]

Acts of bankruptcy are listed in section 42 of the BIA:[69]

(a) in Canada or elsewhere the bankrupt makes an assignment of property to a trustee for the benefit of creditors;

(b) in Canada or elsewhere the debtor makes a fraudulent gift, delivery or transfer of the debtor's property or of any part of it;

(c) in Canada or elsewhere the debtor makes any transfer of the debtor's property or any part of it, or creates any charge on it, that is a fraudulent preference;

(d) the debtor, with the intent to defeat or delay his creditors, departs out of Canada or remains out of Canada or departs from his dwelling or otherwise absents himself;

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65 Automatic in certain circumstances for a corporate proposal, not automatic for a consumer proposal as discussed *infra*.

66 BIA, s 43(1).

67 *Idem*, s 42(1)(a).

68 Wood, *supra* note 20, p 62.

69 BIA, s 42.

(e) permitting, for certain specified periods of time, execution under which the debtor's property is taken;

(f) an admission of his inability to pay debts;

(g) the debtor assigns, removes, secretes or disposes of or attempts or is about to do same with his property with the intent to defraud, defeat or delay his creditors or any of them;

(h) giving notice to creditors that the debtor has suspended or is about to suspend payment of debts;

(i) defaulting on a proposal; and

(j) if the debtor ceases to meet liabilities generally as they become due.

The most common act of bankruptcy is where a debtor ceases to meet liabilities generally as they become due.[70] "Generally" means it is not sufficient to allege that the debtor has failed to pay only the application creditor, unless the applicant creditor is either the only claimant or the debt owed is so large that the claims of other creditors are not of significance in comparison.[71]

The debtor has the right to object to the application, in which case the court determines whether the bankruptcy order should be issued. If the applicant(s) have proven the existence of debt and that an act of bankruptcy has occurred, the court may still dismiss the application if the debtor can demonstrate they have the ability to pay their debts ("able" and "willing" being two different things).[72] If the court is satisfied that the facts in the alleged application have been proven, the judge can make the order of bankruptcy. As soon as the order is made, the property of the debtor vests in a licensed trustee appointed by the court.

At any time after the filing of an application for a bankruptcy order but before the bankruptcy order is made, the Court may appoint a licensed trustee as interim receiver of all or part of the property of the debtor if it is shown to be necessary for the protection of the estate of a debtor. The role of an interim receiver is to preserve and protect the property of the debtor pending the hearing of the application. The interim receiver may be directed by the court to take conservatory measures and summarily dispose of property that is perishable or likely to depreciate rapidly in value.[73]

6.2.2.2 Voluntary bankruptcy

Voluntary bankruptcy occurs when the debtor voluntarily makes an assignment into bankruptcy proceedings. This may be done for a number of reasons, including to stay legal actions by creditors, or, in the case of an individual, to obtain a fresh start once the proceedings have concluded. To be eligible to file a voluntary bankruptcy, the debtor must fall under the BIA

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[70] *Idem*, s 42(1)(j).
[71] See eg *Re Real Time Fibre Supply Ltd,* 2007 CarswellBC 580 as discussed in Houlden *et al*, *supra* note 64, at §5:53.
[72] BIA, s 43(7).
[73] *Idem*, s 46.

definition of insolvent person discussed above. The process does not involve a court application. The company or individual executes an "assignment" of its property for the benefit of its creditors which is accompanied by a sworn statement that discloses the debtor's property, the names and addresses of the creditors, and the amounts of the creditors' claims. These documents are filed with the Official Receiver. Once the documents are accepted, the bankruptcy proceedings are commenced.

In a voluntary proceeding the debtor chooses the trustee, however this selection is subject to confirmation by unsecured creditors at the first meeting of creditors. In an involuntary proceeding, the applying creditor selects the trustee, also subject to confirmation at the first creditors' meeting.

The BIA allows the court to annul a bankruptcy where, in the opinion of the court a bankruptcy order ought not to have been made or an assignment ought not to have been filed.[74] In order to grant an annulment, the court must be satisfied either that (i) the debtor was not an insolvent person when they made the assignment, or (ii) the debtor abused the process of the court, with the debtor's intent determining whether an abuse of process has occurred.[75]

6.2.2.3 Failure of BIA proposal

The BIA contains provisions for both corporate and consumer proposals that allow debtors to reach compromises with their creditors, which are discussed in detail below. Proposals must be accepted by the requisite majorities of creditors and approved by the court. For a corporate proposal to be binding on each class of creditors it purports to affect, a majority of the proven creditors in that class, by number, together with two-thirds of the proven creditors in that class, by dollar value, must approve of the proposal. If a class of creditors approves the proposal, it is binding on all creditors within the class, subject to the court's approval.

If a corporate proposal is rejected by a class of creditors voting on the proposal, the debtor is deemed to have made an assignment in bankruptcy. If the corporate proposal is not approved by the court, the debtor will be deemed to have made an assignment in bankruptcy. If a debtor defaults under the terms of its proposal and such default is not waived by inspectors (creditor representatives that may be appointed by creditors in certain cases) or the creditors themselves (if there are no inspectors), the proposal trustee must inform the creditors and the Official Receiver. Thereafter a motion may be brought to the court to annul the proposal. If such order is granted, the debtor is automatically assigned into bankruptcy.

Note that, as explained below, the failure of a consumer proposal does not result in an automatic bankruptcy and a motion must be brought to assign the individual into bankruptcy.

74 *Idem*, s 181(1).
75 *Wale* (*Wale, Re*, 1996 CanLII 8275 (ONSC) at para 17).

6.2.3 *Directors and bankruptcy*

Under Canadian law, the directors of a company have a fiduciary duty to act honestly and in good faith with a view to the best interests of the company and not to its creditors, shareholders or other stakeholders in particular. This is so even when the company is facing insolvency. However, as clarified[76] by the Parliament of Canada in its 2019 amendments to the CBCA (Canada's federal corporate statute), considering the "best interests" of the company can include considering the interests of shareholders, employees, retirees / pensioners, creditors, consumers, governments, the long-term interests of the corporation and the environment. Directors may consider factors outside of these as well, and ensuring they discharge their fiduciary duty becomes more important as the company enters the "zone of insolvency". While there is no statutory requirement for a company to enter insolvency proceedings at any time, the basic requirement between the various available proceedings is that a company must be "insolvent". The closer a company flies to the edge of insolvency, the greater the potential personal liability of directors (and sometimes officers) for some of the company's debts such as:

(1) Specific debts under federal and provincial laws such as: (i) un-remitted payroll deductions under the federal Income Tax Act, (ii) goods and services tax owing under the federal Excise Tax Act, and (iii) certain wages under the Provincial Employment Standards Act.

(2) Breach of corporate duties. While a director's duties are to the company, these duties can extend to the company's creditors in certain circumstances and the oppression remedy (discussed earlier) provides a broad, discretionary remedy that can be applied to hold directors personally liable.

(3) Guarantees and indemnities. Directors of smaller businesses often give personal guarantees or indemnities to lenders, suppliers, landlords, and other creditors of the company.

6.2.4 *Effect of a bankruptcy on property of the debtor*

On bankruptcy the debtor ceases to have the legal right to deal with its property. All of the debtor's property, with the exception of property held in trust for another, or property that is exempt from seizure under provincial law where the debtor resides, "vests" in the trustee, subject to the rights of secured creditors.[77] The trustee's rights in this regard take precedence over any garnishment, enforcement or judgment unless it is completed before the bankruptcy.[78]

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[76] "Clarified" because the Supreme Court's 2008 decision in *BCE Inc* (2008 SCC 69) set out similar parameters, though the Court's articulation of these parameters left the scope of factors that could (or must) be considered in discharging the fiduciary duty unclear – see Jeffrey Macintosh, "BCE and the People's Corporate Law: Learning to Live on Quicksand" (2009) 48(2) *Canada Business Law Journal* 255.

[77] BIA, s 67.

[78] *Idem*, s 70.

6.2.5 *Stay of proceedings*

There is an automatic stay of proceedings on entering bankruptcy proceedings. Pursuant to this stay, no creditor has any remedy against the debtor or the debtor's property or may commence or continue any action, execution or other proceedings for the recovery of a claim provable in bankruptcy until the trustee has been discharged.[79]

Secured creditors are not subject to the stay and are not prevented from realizing on or otherwise dealing with security unless a Court orders otherwise, subject to the property valuation issues discussed above.[80] In the bankruptcy proceedings of individuals, the stay does not apply to orders to pay child or spousal support.[81]

There are two fundamental purposes behind a stay of proceedings. The first is that by preventing creditors from continuing their claims, a stay allows the trustee to review, accept, reject and value the claims against the bankrupt's estate, replacing lengthy adjudication with a summary process that saves costs. Second, by preventing creditors from commencing or continuing actions against the bankrupt, the stay ensures an orderly liquidation and *pro rata* sharing that collectively enhanced the value ultimately received by all creditors.[82]

Creditors may apply to the court to have the stay against them lifted, such as where they seek to preserve limitation periods, access insurance of the bankrupt, or to determine valuation issues, or that the type of debt owed is not covered by the bankruptcy, such as fraud.[83] The decision to lift the stay is discretionary. In considering whether to lift the stay, the court considers whether (a) the person is likely to be materially prejudiced by the stay or (b) it is equitable on other grounds to make the declaration,[84] in light of the interests of all creditors and the policy objectives of the automatic stay.[85]

6.2.6 *Role of trustee*

The trustee's primary role is to take possession of and secure all the assets owned by the bankrupt and realize upon the assets for the benefits of the creditors. The trustee is also responsible for notifying creditors of the bankruptcy and any meetings of creditors, reporting to the court and the Official Receiver, processing and assessing proofs of claim, distributing proceeds of sale, and, where necessary, investigating and reporting on the bankrupt's affairs. As an officer of the court, the trustee has a broad duty to represent the best interests of all creditors fairly and impartially.

Among the duties a trustee has upon its appointment are the duty to: (i) take possession of and realize on the assets of the bankrupt, (ii) take conservatory measures and summarily dispose of

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79 *Idem*, s 69.3(1) – (1.1).
80 *Idem*, s 69.3(2).
81 *Idem*, s 69.41(1); s 121(4).
82 Wood, *supra* note 20, p 166.
83 Houlden and Morawetz, *supra* note 64, F§114 and F§163.
84 BIA, s 69.4.
85 *Idem*, s 69.4. See also Houlden and Morawetz, *supra* note 64, at §5:277.

the bankrupt's property, and (iii) carry on the business of the bankrupt as necessary (unless in his opinion the realizable value of the property of the bankrupt is insufficient) until the first meeting of creditors is held. Among the various rights of a trustee under the BIA, a trustee has the right to: (i) conduct examinations, (ii) carry on the bankrupt's business, and (iii) sell and purchase property. A trustee also has certain voting and litigation rights. Finally, a trustee is afforded certain protections in terms of its exposure to liability arising from environmental claims or a successor employer situation.

Upon completion of bankruptcy proceedings, the trustee must tender a final report in the form of a final statement of receipts and disbursements that shows all funds, received by the trustee out of the property of the bankrupt (including interest), all funds disbursed and expenses incurred, the remuneration claimed by the trustee, and the particulars of any property of the bankrupt that has not been sold and the reasons why it was not sold.

6.2.7 Creditors proving claims

Under section 121 of the BIA, all debts and liabilities, present and future, to which a bankrupt is subject on the day of bankruptcy, or to which the bankrupt may become subject before discharge by reason of any obligation incurred before the bankruptcy, are claims provable under the BIA. As such, contingent and unliquidated claims are included. Foreign creditors and Canadian creditors participate equally in a bankruptcy and no distinction is made between them.

The bankrupt is required to submit to the trustee a statement of affairs that sets out the names and addresses of all known creditors, including creditors with contingent or unliquidated claims. There is no statutory time limit for filing proofs of claim, but a creditor that does not file a proof of claim cannot vote at meetings of creditors and will not receive a distribution on its claim.[86] The proof of claim submitted by the creditor must show particulars of the claim and make reference to evidence sufficient to show whether the claim has merit.

The Supreme Court of Canada has set out the following conditions for a claim to be provable in bankruptcy:

(1) the debt, liability or obligation must be owed to the creditor;

(2) a debt, liability, or obligation must be incurred before the debtor becomes bankrupt; and

(3) it must be possible to attach a monetary value to the debt, liability or obligation.[87]

After completing the proof of claim, the creditor delivers it to the trustee and the trustee makes an assessment.[88] Where the trustee determines that a contingent or unliquidated claim is a provable claim, the trustee must value it.[89] The trustee may admit the claim in whole or in part.

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86 BIA, s 124(1).
87 Wood, supra note 20, p 443 (*Newfoundland and Labrador v AbitibiBowater Inc* [2012] SCC 67 at para 26).
88 BIA, s 135.
89 *Ibid.*

The trustee may request more information from the creditor to prove its claim. The trustee may also choose to disallow the claim. If the trustee disallows the claim, he must send notice to the creditor. The creditor may then appeal the decision to the court within a 30-day period after service of the notice. If a settlement cannot be reached, the court makes a determination as to the validity, priority and quantum of the claim. An appeal of a trustee's determination is not a hearing *de novo*, absent special circumstances. Where the trustee's decision involves a question of law, the standard of review is one of "correctness". Where the determination is factual or involves a discretionary element, the standard of review is "reasonableness".[90]

6.2.8 Meeting of creditors

Within five days of appointment, the trustee will call the first meeting of creditors by sending out a notice to all known creditors. The first meeting of creditors must be scheduled within 21 days of the date of bankruptcy. At the first meeting of creditors, creditors are able to:

- examine the affairs of the bankrupt by asking questions of the trustee and the bankrupt;
- review the trustee's "statement of affairs" (preliminary report on the bankruptcy, including claims and assets);
- confirm the trustee's appointment or table a motion to replace him;
- instruct the trustee on the administration of the estate; and
- appoint one to five inspectors.[91]

Inspectors are generally creditors appointed by the (other) creditors who, by majority vote, provide the trustee with direction and the authority to take certain actions, such as carrying on the business of the bankrupt or the sale or other disposition of any property of the bankrupt. A trustee must obtain court approval if it wishes to undertake these actions prior to or in the absence of the appointment of inspectors. At the first meeting, the creditors can vote to dispense with inspectors. If there are no inspectors appointed at the first meeting of creditors, the trustee can exercise all of its power on its own accord, except to dispose of assets to a party related to the bankrupt, which still requires court approval. It is often the case that there are no further meetings of creditors after the first meeting of creditors as the inspectors instruct the trustee. Inspectors are required to discharge their obligations for the benefit of all creditors. They must not place their own interests ahead of their duties and they have the obligation to inform the trustee and their co-inspectors each time there is a risk of a conflict of interest.

6.2.9 Repossession of goods

Suppliers have a limited right to recover inventory supplied to a bankrupt debtor. Unpaid suppliers have the right to repossess goods shipped 30 days before the date of bankruptcy or

[90] *Business Development Bank of Canada v Pinder Bueckert & Associates Inc (2009),* 2009 CarswellSask 776 (Sask QB).
[91] BIA, s 116.

receivership. A written demand must be sent within 15 days of the purchaser becoming bankrupt or subject to a receivership.[92] The goods must be identifiable, in the same state as on delivery, still in the possession of the trustee or receiver, and not subject to an arm's-length sale. In practice, it is often not possible for suppliers to satisfy these requirements.

6.2.10 Exempt property

Exempt property applies to the bankruptcy of individuals and not corporations. **With the exception of trust property held for another and RRSPs** (a type of tax exempt retirement savings account), **bankruptcy exemptions in Canada** are set by provincial legislation.

How much of each exempt asset class a debtor can retain depends on the province or territory in which they live. Generally, the types of assets that a debtor can keep in a bankruptcy include:

(a) personal items and clothing;

(b) household furniture, food and utensils in the debtor's permanent home;

(c) tools necessary to a debtor's work;

(d) a motor vehicle with a value up to a certain limit; and

(e) certain farm property.

In some provinces there is a limited homestead exemption. For instance, in Ontario, under the Execution Act[93] the principal residence of the debtor is exempt from forced seizure or sale if the value of the debtor's equity in the principal residence does not exceed the prescribed amount of CAD 10,000.[94]

Under section 67 of the BIA, amounts held by individuals in RRSPs are exempt from seizure in bankruptcy, subject to a possible claw-back for contributions made in the 12 months preceding bankruptcy. Where provincial legislation exempts RRSPs from execution, the provincial legislation will apply. Where provincial legislation is silent regarding the treatment of RRSPs, they will be exempt subject to the claw-back referred to above.

6.2.11 Executory contracts

Generally, bankruptcy does not terminate a contract in and of itself. Provided post-filing obligations are kept current, the contract continues and counter-parties are stayed from terminating contracts for pre-filing breaches. The benefits of contracts, other than contracts of a personal nature, vest in the trustee. Bankruptcy does terminate contracts of employment due to their personal nature. The trustee may exercise his or her discretion to repudiate, assign or

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[92] *Idem*, s 81.1.

[93] Execution Act [1990], c E 24, s 2(2).

[94] Macdougall, *supra* note 54, p 438.

perform all or part of contracts that are not terminated for the benefit of creditors.[95] If the trustee does not within a reasonable time affirm the contract, the counter-party is entitled to treat the contract as breached and file a proof of claim for damages in the bankruptcy. The date of the first meeting of creditors has been held to constitute a reasonable period of time.[96] Pre-filing arrears of contracts form an unsecured claim in the bankruptcy. The ability to perform all or part of a contract during the bankruptcy can be an important value maximization tool for the estate, such as where a business has a production run in process that will result in a significant payment if completed.

6.2.12 Assignment of contracts

The BIA contains provisions that allow for the assignment of contracts notwithstanding that the agreement contains a restriction on assignment.[97] These provisions specifically exclude contracts entered into after the date of bankruptcy, commercial leases, eligible financial contracts, collective bargaining agreements (union contracts) and agreements that are not assignable by reason of their nature, such as personal services contracts. The approval of the trustee is required for any assignment. Before effecting the assignment of the debtor's rights under a contract, the court will consider factors such as (i) the ability of the assignee to perform the obligations, and (ii) the appropriateness of the assignment of the rights and obligations. The court may not order the assignment unless all monetary defaults are remedied by a date fixed by the court. In the case of an individual, they may not seek to assign an agreement unless they are carrying on a business and only the rights and obligations in relation to the business may be assigned.[98]

6.2.13 Essential utilities

No public utility may discontinue service to a bankrupt individual by reason only of the individual's bankruptcy or insolvency or of the fact that the bankrupt individual has not paid for services rendered or material provided before the time of the bankruptcy. These restrictions do not prohibit a counter-party of utility from requiring payments to be made in cash for goods, services, use of leased property or other valuable consideration provided after the time of the bankruptcy and nor do they require the further advance of money or credit.[99]

6.2.14 Ipso facto clauses

Ipso facto clauses purport to terminate, amend or accelerate payment in the event that the counterparty to the contract becomes insolvent.[100] In CCAA and BIA proposal proceedings, creditors are explicitly stayed from exercising *ipso facto* clauses. Such clauses are not explicitly statutorily stayed in the provisions of the BIA dealing with court-ordered receiverships, but the standard template appointing order includes a provision rendering them inoperative. The BIA

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[95] BIA, s 30(1)(k); *Re Thompson Knitting Co* [1925] OJ No 212.
[96] Houlden, Morawetz and Sarra*, supra* note 64, at §5:252.
[97] BIA, ss 65.11, 66 (1.1), 84.1 and 146 and Bankruptcy and Insolvency General Rules, ss 94.1 and 95 and Form 44.1.
[98] BIA, s 84.1(2).
[99] *Idem*, s 84.2.
[100] *Idem*, ss 65.1 and 84.2; CCAA, s 34.

also expressly renders *ipso facto* clauses inoperative in individual bankruptcies.[101] There is some debate based on the use of the word "individual" that Parliament deliberately did not provide the same express protection against *ipso facto* clauses in corporate liquidating bankruptcies.[102] In the author's view, the better reading is that the provisions of Canada's insolvency regime should be read harmoniously to avoid asymmetrical entitlements that incentivize creditors towards liquidation rather than restructuring. An interpretation of the statute such that *ipso facto* clauses are not stayed or rendered inoperative by a corporate bankruptcy filing would eviscerate the value-maximizing provisions discussed above that allow the assumption and assignment of contracts by the trustee.

6.2.15 Impeaching pre-bankruptcy transactions

Under Canadian insolvency law, trustees have several remedies for the review and avoidance of pre-bankruptcy transactions by an insolvent debtor. The BIA contains provisions in sections 95 and 96 that allow the trustee to seek impeachment of "transfers at undervalue"[103] (TUVs) or "preferences".[104] A trustee may also pursue suspected fraudulent conveyances or fraudulent preferences under provincial Fraudulent Conveyances Act legislation and / or Assignments and Preferences Acts (FCA legislation).[105] There are two competing objectives at play with all such remedies: preventing conduct that violates the principle that creditors should share ratably amongst each other in an insolvency, but in turn respecting the finality of good faith transactions.[106]

The provisions of the BIA create certain rebuttable presumptions based on the relationship of the parties and the timing of the impugned transactions relative to the debtor's "initial bankruptcy event". The initial bankruptcy event is the earliest of the filing of a voluntary assignment, a proposal, a notice of intention to file a proposal, a CCAA filing or the first application for an involuntary bankruptcy order against the debtor.

6.2.15.1 TUVs

TUVs are transactions in which no consideration was received by the debtor, or where the consideration received was less than the fair market value given by the debtor.[107] On application to impeach a TUV by the trustee, the court must determine as a question of fact (1) whether the transfer was at undervalue, and (2) whether the parties were or were not dealing with each other at arm's length. Persons who are related to each other are deemed not to deal at arm's length unless there is evidence to the contrary.

[101] BIA, s 84.2.
[102] *Idem*, s 84.2. See eg Halsbury's Laws of Canada, *supra*, p 245.
[103] Wood, *supra* note 20, p 190 (BIA s 96(1)).
[104] *Idem*, p 190 (BIA, s 95(1)).
[105] See, eg, GSBC 1996, c 163.
[106] Wood, *supra* note 20, p 191.
[107] BIA, ss 95 and 96.

If the court finds that the transaction was a TUV and that the other party was not at arm's length, the court may void the transaction or grant judgment for the difference between the actual consideration and the fair market value if:

(1) the TUV was within one year before the date of the initial bankruptcy event; or

(2) the TUV was within one to five years before the date of the initial bankruptcy event and the debtor was insolvent at the time of the TUV or intended to defeat the interests of creditors.

If the court finds that the transaction was a TUV and that the other party was at arm's length, the court may void the transaction or grant judgment for the difference between the actual consideration and the fair market value if:

(1) the TUV was within one year before the bankruptcy; and

(2) the trustee can prove both (i) the debtor was insolvent at the time of the transfer (or was rendered insolvent by it), and (ii) the debtor intended to defraud, defeat, or delay a creditor.

Intent is a question of fact arising from the totality of the circumstances. An inference of intent arises from one or more "badges of fraud". Examples of badges of fraud include (i) the transferor having few remaining assets after the transfer, (ii) the instrument of transfer containing self-serving and unusual provisions, (iii) the transfer having been conducted in secret, and (iv) unusual haste in the transfer.[108]

6.2.15.2 Preferences

A preference arises if a debtor elects to pay only one or a few of his creditors and not the others, with the consequence of preferring certain creditors. To attack a transaction as a preference the trustee must establish:

(1) That the debtor transferred property, provided services, charged property, made payment, incurred an obligation or suffered judicial proceedings in favor of the creditor:

  (a) within three months of the initial bankruptcy event if the creditor is dealing at arm's length with the debtor; or

  (b) within 12 months of the initial bankruptcy event if the creditor is not arm's length;

(2) That the debtor was insolvent at the time of the transfer; and

(3) The transfer had the actual effect of giving the creditor a preference over the debtor's other creditors.

[108] *Halsbury's Laws of Canada* (online), Bankruptcy & Insolvency, "Trustees' Recourses: Fraudulent Preferences: Provincial Preferences Legislation: Intention to Prefer" (V.2(3)(d)(ii)) at HB-152 "When intention must be proven" (2021 Reissue).

If the trustee established these three elements, a rebuttable presumption arises of an intention to prefer and the onus shifts to the creditor to prove that the debtor did not intend to give a preference. Evidence of pressure (as opposed to commercial imperative) is not admissible to support a transaction.[109] Evidence of an ordinary course transaction (that is, in the usual manner with no intention to prefer the arm's length creditor), a transaction necessary to stay in business (such as refusal by a creditor to provide further necessary goods or services), or a pre-existing agreement to transfer (where the transfer is pursuant to an agreement that was concluded prior to the look-back period while the debtor was still solvent) may be sufficient to rebut the presumption.

6.2.15.3 Incorporation into the CCAA by reference

The BIA's TUV and preference provisions discussed above are incorporated into the CCAA by reference.[110] In CCAA proceedings it is the monitor that is granted the right to pursue the remedies on behalf of the estate. Monitor's and proposal trustees must report on the reasonableness of a decision to exclude the application of the TUV and preference provisions from a proposal or a CCAA plan (that is, not to challenge the preference or the TUV transaction).

6.2.15.4 Provincial FCA legislation

Provincial FCA legislation operates concurrently with the BIA because the preferences provisions in the BIA do not encompass all transactions covered under provincial law, which is broader in scope. Provincial FCA legislation is similar to the BIA, but there are some key differences. First, under the provincial statutes the courts look to the concurrent intent of both the debtor and the creditor, under the BIA only the debtor's intent is relevant. Second, under the provincial statutes there is no review period, whereas under the BIA only transactions within the specified review periods can be attacked. Third, under the FCA legislation debtors do not need to be in formal insolvency proceedings for creditors to attack transactions – the debtor must be insolvent or near insolvency.[111] Finally, under the FCA legislation there is no rebuttable presumption of intent.

6.2.16 Set-off

Canadian insolvency law recognizes claims for "legal set-off" and "equitable set-off" in both liquidations and reorganizations. Legal set-off requires that claims be both liquidated and mutual. Equitable set-off can exist whether or not debts are liquidated or unliquidated. Instead, the court looks at the connection between the various claims in respect of which set-off is asserted. If the connection between such claims would make it unfair or inequitable to permit one party to recover its claim without permitting the other party to set-off what is owed to it, the courts will permit the claims to be set-off against each other. Valid set-off claims are expressly

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[109] BIA, s 95(2).
[110] CCAA, s 36.1.
[111] *Halsbury's Laws of Canada* (online), *Bankruptcy & Insolvency* "Additional Matters under the Bankruptcy and Insolvency Act: Bankrupts: Examination of Bankrupt and Others" (XII.5(2)) at HB-565 "Examination under oath" (2021 Reissue).

preserved in the BIA.[112] Rights of set-off are determined as of the date of the bankruptcy. Both the BIA and CCAA contain special provisions that expressly permit netting of particular types of financial contracts such as swaps, repurchase agreements and commodity contracts.

6.2.17 Section 38 – proceeding by creditor where trustee or monitor refuses to act

If there are not sufficient estate assets to pursue such remedies, creditors can apply to the court for an order pursuant to section 38 of the BIA to pursue the trustee's remedies (or in CCAA proceedings, the monitor's), for the benefit of those creditors that fund the proceedings, with any surplus distributed to the other creditors on a *pro-rata* basis.[113] This can be a powerful remedy for motivated creditors where a trustee or monitor is unable or unwilling to act in respect of an impeachable transaction.

6.2.18 Examination of the bankrupt or other persons

A significant right granted to creditors by the BIA is the ability to instruct the trustee to seek examination under oath of the bankrupt or any person having knowledge of the conduct or affairs of the bankrupt to aid in the recovery of assets for the benefit of the estate. On application to the Court, by a creditor, or other interested person, and on sufficient cause being shown, the Court may order the examination of the bankrupt or any other person for the purpose of investigating the administration of the bankrupt estate. The court may also order delivery of documents relating to the bankrupt, its dealings or property.[114] This broad power is often used in conjunction with the BIA TUV and preference provisions to obtain evidence to support exercise of the trustee's avoidance remedies.

6.2.19 Priorities

The priority of claims in Canadian insolvency proceedings can be exceedingly complex due to the interaction of various priority government claims, trust claims, statutorily ranked claims, court ordered priorities (discussed *infra*) with the ordinary categories of secured and unsecured claims. In some instances, priorities can differ depending on the type of insolvency proceeding.

The BIA contains a statutory scheme that governs the ranking of claims in sections 136 to 147. In a corporate bankruptcy the rights of secured creditors rank ahead of all claims against the debtor, except for certain "super-priority" claims. These super-priority claims include:

(a) claims for unpaid employee payroll tax deductions owed to the Canadian taxing authority (known as source deductions);

(b) claims by suppliers for the return of goods supplied to the debtor company in the 30-day period prior to bankruptcy (discussed above); and

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[112] BIA, s 97(3).
[113] *Idem*, s 38.
[114] *Idem*, s 161.

(c) claims for up to CAD 2,000 for unpaid salary, wages, commissions and benefits for amounts paid by the federal government to employees under the Wage Earner Protection Program Act (WEPPA); and

(d) amounts deducted and not remitted and for unpaid regularly scheduled contributions (that is, not special contributions or the underfunded liability itself) to a pension plan.[115]

Once super-priority claims and secured claims are satisfied, preferred claims are paid. There are 13 preferred claims in the BIA and each must be satisfied in the specified order before any persons in other categories may be paid out. Preferred claims include fees of the trustee and its legal counsel and claims for up to three months of arrears of rent and three months of future rent by landlords. Once preferred claims are paid, the claims of general unsecured creditors are paid *pari passu*.

Equity (shareholder) claims may not recover until all creditor claims have been paid in full and there is a surplus, which rarely occurs. In general, shareholders have no influence over the liquidation or restructuring of a debtor company under any of Canada's insolvency and restructuring regimes.

There are reasons related to creditors' relative priority that explain why a bankruptcy can be advantageous to a secured creditor stemming from the interplay between federal and provincial legislation and the paramountcy doctrine. There are a number of federal and provincial statutory liens and deemed trusts that have priority over secured creditors outside of bankruptcy, but which are treated as ordinary unsecured claims following bankruptcy (for example, liens for unremitted federal and provincial sales tax). As a result, CCAA liquidations and receivership proceedings are often converted into a "strategic" bankruptcy once super-priority claims and secured creditor claims are satisfied to retroactively reverse these priorities.[116]

6.2.20 Conversion of bankruptcy to restructuring proceeding

A corporate or consumer bankruptcy can be converted into corporate or consumer proposal proceedings by a trustee filing a "Notice of Intention to file a Proposal" or filing a proposal to creditors (both discussed in more detail below in the section on rescue). A liquidating bankruptcy can be converted to CCAA proceedings by court order with the consent of the inspectors.[117] BIA proposal proceedings may be transitioned to CCAA proceedings by court order where no proposal has yet been filed.[118] Where an insolvent company or individual becomes solvent during proceedings, a bankruptcy can be annulled.

[115] *Idem*, ss 136-147.
[116] *Callidus Capital Corp v Canada* [2018], SCC 47.
[117] CCAA, s 11.6 (b).
[118] *Idem*, s 11.6(a). See discussion of applicable test in *Re Clothing for Modern Times Ltd*, 2011 ONSC 7522.

6.2.21 Alternatives to formal bankruptcy for individuals

The BIA proposal process applicable to corporations is discussed below in the section on corporate rescue. This section focuses on the alternatives to personal bankruptcy available to individuals.

6.2.21.1 Summary administration bankruptcy

A summary administrative bankruptcy is available to consumers whose assets do not exceed CAD 15, 000. The process is relatively straightforward and gives debtors an alternative to formal bankruptcy. The advantages for the debtor is that there is no requirement to advertise the bankruptcy or call a first meeting of creditors. Under a summary administration bankruptcy, the debtor is eligible for an automatic discharge after nine months.[119] Trustee fees and disbursements are fixed by bankruptcy legislation in a summary administration and are not charged based on time or asset value.

6.2.21.2 Consumer proposals

Consumer proposals allow insolvent individuals with debts of CAD 250,000 or less (excluding the mortgage on a principle residence) to reach payment compromises with their creditors to avoid the stigma of bankruptcy proceedings.

In a consumer proposal the debtor's property does not automatically vest in a trustee and the process does not involve a complete liquidation of the debtor's assets. A proposal is created with the assistance of a trustee – an offer to pay creditors a percentage of what is owed to them, or extend the time to pay off the debts, or both. The term of a consumer proposal cannot exceed five years. The creditors then vote to either accept or reject the proposal by a resolution carried by the majority of votes (one vote for each dollar of debt) of the accepted claims of creditors at a meeting of creditors.[120] If the proposal is approved by a simple majority of the creditors, the proposal is binding on all creditors, regardless of their vote. If the consumer proposal is not accepted, the debtor can make changes to the proposal and resubmit it; or declare bankruptcy.

If the debtor fails to make three consecutive monthly payments, the proposal is automatically annulled. All funds that have been paid are forfeited, all penalties, fees, and interest charges are reinstated and creditors may resume enforcement proceedings. The debtor may seek to negotiate a new proposal or seek court approval to re-instate the proposal within 30 days. Creditors may bring a motion on annulment of a failed consumer proposal to assign the debtor into bankruptcy.

6.2.21.3 Orderly payment provisions

The BIA includes "orderly payment provisions" (OPD) in Part X as another alternative to consumer bankruptcy. Currently OPD is only available in the provinces of Alberta, Saskatchewan

[119] "What types of Personal Bankruptcy are there in Canada?", *Bankruptcy Canada*, online at https://bankruptcy-canada.com/bankruptcy-blog/what-types-of-personal-bankruptcy-are-there-in-canada/.
[120] Wood, *supra* note 20, p 564.

and Nova Scotia. The OPD provisions allow for a debtor to consolidate unsecured debts into a single amount with a prescribed rate of interest and subsequently pay amounts into the court to pay off the consolidated debt over time. Certain types of debts such as income taxes or business debts are not included. The court distributes the amounts of the periodic payments to the creditors by way of dividends. To be eligible for the OPD requirements, the debtor must not be a corporation and must apply to the clerk of the court by way of affidavit that sets out the debtor's financial obligations. If the clerk approves a structuring under the OPD, the creditors are notified and given a chance to object. The consolidation order must provide that the debtor pay off all debt within three years or less.[121] Where a creditor has initiated enforcement remedies, the OPD process may not apply.

6.2.21.4 Voluntary deposit, Quebec

Voluntary deposits are an equivalent to the OPD for debtors who reside in Quebec. The provisions allow debtors to make regular, monthly payments to the Court based on their income and dependents with a prescribed rate of interest. The Court then ensures that these payments are distributed to creditors.

The voluntary deposit protects the debtor against salary garnishments and seizure of furniture found in the residence. It does not, however, protect the debtor from seizure of the home, assets and / or furniture financed by an installment sales contract, bank accounts or a vehicle.

6.2.22 Discharge of the individual bankrupt

An individual bankrupt is automatically discharged nine months after the bankruptcy is filed if:

(1) it is a first bankruptcy;

(2) the bankrupt has attended two financial counselling sessions;

(3) the bankrupt is not required to pay a portion of his income into the bankruptcy estate as per the standards established by the OSB; and

(4) the discharge is not opposed by a creditor, the trustee or the OSB.[122]

If it is the bankrupt individual's first bankruptcy, the trustee's report would provide the parties interested in the bankruptcy with sufficient information to object to a discharge or not. The report sets out the causes of bankruptcy and the conduct of the debtor throughout the insolvency process.[123] If the interested parties are satisfied with the report and there are no objections, the bankrupt will be automatically discharged. If the bankrupt is required to pay a portion of his/her income into the bankruptcy estate, and it is a first bankruptcy, the bankrupt

[121] *Idem*, p 564 (BIA, ss 219(2) and 220(1)).
[122] "Bankruptcy Discharge and its Consequences for the Bankrupt", *Government of Canada*, online at https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02677.html.
[123] Wood, *supra* note 20, p 295 (BIA, s 170(1)).

will be eligible for an automatic discharge after contributing to the estate for 21 months.[124] A longer period of 24 months is mandated if the bankrupt has been bankrupt once before, in either Canada or another prescribed jurisdiction.

As the discharge period is coming to a close, the trustee must provide the bankrupt and creditors a notice of impending discharge at least 15 days before the automatic discharge comes into effect. Any opposing parties are then presented with the ability to oppose the discharge by providing notice setting out their position. If there is any opposition to the discharge, the trustee is required by law to apply to the court for a hearing on the matter.[125]

Other instances where an individual bankrupt is required to go to court and not eligible to receive an automatic discharge, is when the bankrupt does not complete his duties each month. Duties may include providing the trustee with proof of income each month, attending counselling sessions, providing tax information or making required payments. Should this be the case, the bankrupt is required to go to court and explain why they were unable to complete their duties as mandated by the BIA and the trustee.[126] Additionally, if it is the bankruptcy's third bankruptcy, they will also be required to go to court to receive a discharge.

6.2.23 Debts not released by discharge

Certain debts are not released by a discharge order. These debts for the most part comprise debts resulting from morally reprehensible conduct such as fraud or sexual assault, fines or restitution orders, debts that society has a policy interest in preventing debtors from avoiding through misuse of the BIA such as matrimonial and child support, or debts such as student loan debt where the government has entered into agreements with financial institutions to fund loans and discharge limitations as a *quid pro quo*.[127]

Self-Assessment Exercise 3

Question 1

Assume the only assets of a BV registered company consist of sales proceeds of less than CAD 500,000 held by lawyers in Canada arising from the sale of a property located in Canada. Setting aside any issues under BV corporate or insolvency law, can the company file for voluntary bankruptcy in Canada? If so, can a foreign creditor with a litigation claim that has not resulted in a final judgement seek to prove that claim and participate in the Canadian proceedings?

[124] "Bankruptcy Discharge and its Consequences for the Bankrupt", *Government of Canada*, online at https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br02677.html.
[125] Wood, *supra* note 20, p 295 (BIA, s 168.2(2)).
[126] "Your Bankruptcy Discharge", Bankruptcy Canada, online at https://bankruptcy-canada.com/how-to-file-bankruptcy-canada/bankruptcy-discharge/.
[127] BIA, s 178 (1).

Question 2

How are executory contracts treated in a liquidating corporate bankruptcy?

Question 3

A debtor grants security to an arm's length creditor for past indebtedness two months before the debtor files for voluntary assignment into bankruptcy. Can the grant of security be challenged by the trustee? What if the grant of security is made for both past indebtedness and future obligations in favour of a critical supplier?

Question 4

If there aren't sufficient assets in the estate to pursue an impeachable transaction, is there any mechanism for creditors to pursue the action themselves?

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.3 Liquidation under the WURA

The liquidation of certain specifically listed types of insolvent federal corporations, such as banks, trust companies and insurance companies, is controlled by the statutory provisions of the Winding Up and Restructuring Act[128] (WURA). Under the WURA, the entity must be insolvent. The application may be made by the company itself or by a creditor who is owed the sum of at least CAD 200.[129] Once an application has been granted, the WURA gives the court authority to appoint a liquidator who takes custody and control of all of the property of the company.[130]

Due to the small number of bank, trust and insurance company bankruptcies in Canada, the WURA remains of limited use. Although there are similarities between the WURA and the BIA, the process under the WURA is largely court driven due to the complexity and enormity of a bank liquidation, making the role of the liquidator larger and more complex than that of a trustee in bankruptcy.[131]

6.3.1 Liquidator under the WURA

The WURA lists a number of powers the liquidator may exercise with the approval of the court, such as: bringing or defending actions on behalf of the company, carrying on the business of the company or disposing of its property and assets. The WURA also contains an important

[128] [1985] c W-11.

[129] S Ben-Ishai, "Bank Bankruptcy in Canada: A Comparative Perspective", *Banking and Finance Law Review*, Vol 24, No 3 (2008), p 66. See WURA, s 6(1).

[130] *Ibid*. See WURA, s 33.

[131] *Idem*, pp 65-66.

"catch-all" provision that permits the liquidator, with the approval of the court, to "do and execute all such other things as are necessary for winding up the affairs of the company and distributing its assets".[132] Within 120 days of appointment the liquidator is required to prepare a statement of the assets, debts and liabilities of the company. Once this has been prepared, the liquidator may distribute the assets pursuant to the distribution scheme set out in the WURA, subject to the supervisory discretion of the court.

6.3.2 Avoidance provisions

Similar to the BIA, the WURA provides for avoidance provisions for fraudulent conveyances and fraudulent preferences for pre-bankruptcy transactions or dealings. The fraudulent preferences sections in the WURA are intricate and are generally considered to be somewhat opaque as they are based on an intention-based test focused on the creditor.[133]

6.3.3 Stay of proceedings

The WURA provides for a stay of proceedings against a company both before and after the winding up order is granted. As opposed to a complex set of statutory rules, significant judicial discretion is provided. The court may stay proceedings against the company at any time after a petition for winding up order is presented to the court on terms the court sees fit.[134] Once the winding up order has been made, all proceedings against the company are stayed except with leave of the court and on the terms the court may choose to impose.

6.4 Receivership

A receiver is a licensed professional who is given the authority to deal with a debtor company's assets, including authority to operate and manage the business in place of the existing management, and to shut down the business if the receiver concludes the continued operations will likely erode recoveries for creditors, or if there is insufficient funding to continue operations. The debtor company's assets do not vest in the receiver. Rather, the receiver will have the right (but not the obligation) in the instrument appointing it (contract or court order) to take possession and custody of the assets and to sell them and after deducting the receivership's fees and expenses and distributing the proceeds from the sale to creditors on a priority basis. There are two types of receivers: a privately-appointed receiver and a court-ordered receiver.

Receivership developed in Canada as an equitable remedy under the common law to protect the interests of secured creditors. Subsequent amendments to the BIA have codified many of the common law developments in receivership law. Receivership can address a number of objectives. Receivership may be used to replace inefficient management for an otherwise profitable company that struggles to meet its liabilities. Receivership may be used to protect and preserve assets on an interim basis where there is a dispute as to their ownership, or a risk they may be depleted before claims to them are resolved. Receivership may be used to enforce a secured party's interests in collateral when debtors are unable to pay their liabilities to a

[132] *Idem*, p 68. See WURA, s 35(1).
[133] *Idem*, p 69. See WURA, ss 100(3) and 101(3).
[134] *Idem*, p 70.

secured creditor as they become due. Lastly, in connection with enforcement, receivership may be used to facilitate a going-concern sale of the business to a new buyer free and clear of pre-existing liabilities.

6.4.1 Private receivers

A privately-appointed receiver will be provided for in the security agreement between the debtor and the secured creditor. The secured creditor has a contractual right to appoint a receiver if the debtor is unable to meet its obligations. A private receiver's duties are primarily to the secured creditor that appointed it. Nonetheless, a private receiver has a general duty to act honestly, in good faith and in a commercially reasonable manner, including to attempt to maximize recoveries and to obtain the best price for the debtor's assets in the circumstances.[135] Private receiverships generally do not involve court attendances and can be quick and cost effective. Concerns over successor liability to receiver's carrying on business mean private receivers are not often used. Private receivers are most often used where there is a small business or a discrete pool of assets and there will not be competing creditor claims or disputes with the debtor.

6.4.2 Court-appointed receivers

Section 243 of the BIA authorizes a secured creditor to apply to the court for the appointment of a receiver with national authority to take control of the business when the debtor is unable to meet its obligations under the security agreement. The Courts of Justice Acts of the individual provinces also allow the court to appoint a receiver on application by any interested party (including shareholders or unsecured creditors) where it is "just and convenient" to do (called an "equitable receiver"). Court appointments usually occur in more complex cases, especially where there are competing claims between creditors or disputes between the creditor and the debtor, or in cases where it appears likely from the outset that the assistance of the court will be required on an ongoing basis. A court-appointed receiver will also provide a greater degree of comfort for creditors and professionals from a potential liability standpoint than a private receiver because the court must approve many of the receiver's decisions along the way. For example, a sale process for the business may be approved by the court as fair and reasonable, allowing the receiver and any potential purchaser to be less concerned about sale process decisions being scrutinized by the courts later.

A receiver appointed by the court derives its powers from the court order and any specific legislation governing its powers. In practice, the appointing court typically issues a broad stay of proceedings restricting creditors from exercising any rights or remedies without first obtaining permission from the court, rendering *ipso facto* clauses inoperable, prohibiting all parties including utilities from terminating contracts for pre-filing breaches, and providing for a super-priority charge for the receiver's professional fees and that of its counsel and the appointing creditor over the assets. The court-appointed receiver is also permitted to borrow on a super-priority basis, akin to DIP financing. In appropriate cases the court may order critical suppliers to provide continued supply on fair market cash-on-delivery terms. Commercial courts

[135] Rogers and Huff, *supra* note 26, p 18.

in Canada have developed template receivership orders that set out the generally accepted powers and provisions of appointment, although it is possible to add or delete provisions to meet the individual circumstances of a case.[136]

Under section 244 of the BIA a secured creditor must provide a statutory 10-day notice of its intention to enforce its security and appoint a receiver, if such receiver is to be appointed over all or substantially all of the inventory, accounts receivables or other property of an insolvent debtor. As a practical matter, secured lenders typically issue a "section 244 notice" whenever enforcing security, out of an abundance of caution. As discussed below, an interim receiver may be appointed prior to the expiry of the 10 day notice period where necessary to protect or preserve assets on an interim basis.

A court-appointed receiver is an officer of the court and has duties to all creditors of the debtor. It reports to and takes directions and instructions from the court, not the creditor that first sought its appointment. In most cases, the court order appointing the receiver gives the receiver broad powers similar to those normally granted to a privately appointed receiver under a security agreement; although certain actions, such as major asset sales, usually require court approval. On sale of the assets the court will provide an order that vests title in the property to the purchaser free and clear of prior encumbrances and claims, which thereafter "attach" to the sales proceeds without change to their priority. In this way receivership can provide for "clean" title to the assets of a business.[137]

The BIA also provides for the appointment of "interim receivers" to protect and preserve assets.[138] Interim receivers may still take possession of the property of the debtor, and exercise such control over the debtor's property and business as the court determines appropriate. However, interim receivers are only permitted to take conservation measures and summarily dispose of perishable or rapidly depreciable property of the debtor. The appointment of the interim receiver expires on the earlier of: (a) the taking of possession by a receiver or a trustee in bankruptcy of the debtor's property, and (b) the expiry of 30 days following the day on which the interim receiver was appointed or any period specified by the court, or in the case that an interim receivership coincides with a proposal, upon court approval of the proposal.

Once a court-appointed receiver has realized on the assets of the debtor, it will seek to distribute proceeds to creditors in accordance with their entitlements and priority, which generally requires court approval. If the only recovery is to secured creditors, there may be no need for a claims process. If there are any surplus funds after satisfying all secured claims, the receiver may run a court-sanctioned claims process or seek the court's approval to assign the debtor into bankruptcy and have unsecured claims dealt with through bankruptcy proceedings.

6.4.3 Reporting requirements of receivers

Both private and court appointed receivers have certain obligations mandated by their appointment. The receiver must provide notice of its appointment to all known creditors and

[136] www.ontariocourts.ca/scj/files/forms/com/receivership-order-EN.doc.
[137] www.ontariocourts.ca/scj/files/forms/com/approval-and-vesting-order-EN.doc.
[138] BIA, ss 46 and 47.

prepare and distribute interim and final reports concerning the receivership. These reports are filed with the OSB and made available to all creditors. Court-appointed receivers must also report to the court itself as and when necessary or required about how its mandate is being carried out.

6.5 Corporate rescue

6.5.1 General

Canada has robust and flexible "rescue"-focused insolvency remedies that allow the debtor to remain in control of its assets while it seeks to restructure.[139] The restructuring vehicles in the BIA and the CCAA are driven by the same policy imperatives in that they both aim to avoid the economic and social harms that can come from liquidation. Restructuring is largely seen as the primary goal in the Canadian insolvency regime and courts will do everything reasonably possible to ensure that businesses can continue as a going-concern, even if by way of going-concern sale of all or part of the business to a third-party purchaser.

There are a number of significant similarities between CCAA and BIA restructuring procedures. Both proposals and plans are in essence contractual arrangements that provide for the compromise and arrangement of claims against the debtor. Both proposals and plans must be approved by "double-majorities" (majority in number, two-thirds in value) of each class of creditors that votes on them. There are no Chapter 11 style "cram down" provisions that allow a dissenting class to be overridden in either CCAA or BIA proposal proceedings. Both proposals and plans must then be approved by the courts and thereafter become binding on all creditors, regardless of how they voted. Key elements of a proposal can be substantially the same as the key elements of a CCAA plan. The same basic restrictions and limitations that apply to CCAA plans, also apply to BIA proposals. DIP financing, DIP charges, the assignment of contracts, the disclaimer of contracts, the granting of other priority charges, including critical supplier charges, and the ability to sell assets, free and clear of liens and encumbrances, are all available in both BIA proposal proceedings and CCAA proceedings.[140]

Other than the CAD 5 million monetary threshold, the essential difference between a restructuring under the CCAA and one conducted under the BIA is that a BIA proposal process has more procedural steps set out with strict timeframes, rules and guidelines. A CCAA proceeding is, relative to BIA proposal proceedings, more discretionary and judicially-driven. Debtor companies and other key stakeholders that may support the restructuring process typically prefer the flexibility afforded by the CCAA over the more rigid regime of the BIA. Also, a BIA proposal must be made to unsecured creditors whereas the CCAA can be used to compromise secured creditor claims, while leaving unsecured claims unaffected.

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[139] K P McElcheran, *Commercial Insolvency in Canada*, (4th ed, LexisNexis Canada), p 240 (hereinafter referred to as McElcheran).

[140] Rogers and Huff, *supra* note 26, p 11-12.

6.5.1A New duty of "good faith"

Both the BIA and CCAA have recently been amended to require that all participants in insolvency proceedings "act in good faith".[141] The statutes now give courts unfettered discretion to craft an appropriate remedy where this obligation is breached. It should be noted that the CCAA and BIA both already imposed duties of good faith on Court officers, including trustees in bankruptcy, receivers and monitors in CCAA proceedings, and also on companies seeking to obtain or extend a stay of proceedings. Those duties have been the subject of some judicial consideration, but are arguably different in kind from a general duty that is now owed by all participants in insolvency proceedings.

The Supreme Court of Canada has recently provided some guidance on the duty of good faith in contractual performance, which provide guidance on the standard of conduct required of contracting parties in all contexts, including in insolvency proceedings.

In *Bhasin v Hrynew* the SCC recognized a general organizing principle of good faith in contractual performance, which requires that parties perform their contractual obligations "honestly and reasonably and not capriciously or arbitrarily".[142] The Court noted that acting in good faith means that parties must have appropriate regard for the legitimate interests of their counterparties. The Court clarified that in contrast to fiduciary duties, good faith performance does not require duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first.[143] However, the duty of good faith does require that parties not undermine the other party's interests in bad faith.

The *Bhasin* case also provides that the duty of good faith includes a duty of honest performance in matters relating to contractual performance.[144] This duty imposes a minimum standard of honesty which requires contracting parties not to "lie or knowingly mislead" each other about matters directly relating to contractual performance.[145]

The SCC's decision in *C.M. Callow Inc. v Zollinger* provides further guidance related to the duty of honest performance. In *Callow*, the SCC held that the duty of honest performance precludes parties from actively misleading their contractual counterparts and requires them to correct misapprehensions created by their active deceptions if and when they become known.[146] The SCC noted that whether or not a party has "knowingly misled" their counterparty is a highly fact-specific determination and includes but is not limited to direct lies, half-truths, omissions, and silence depending on the circumstances.[147]

As discussed further below, the principles affirmed by the SCC related to the organizing principle of good faith in contractual performance and the corresponding duty of honest performance provides guidance on how parties can conduct themselves in a manner that does

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[141] CCAA, s 18.6 (1); BIA, s 4.2(1).
[142] *Bhasin v Hrynew*, 2014 SCC 71 at para 63 (hereinafter referred to as *Bhasin*).
[143] *Idem*, para 65.
[144] *Idem*, para 73.
[145] *Ibid*.
[146] *C.M. Callow Inc. v Zollinger*, 2020 SCC 45 at para 81 (hereinafter referred to as *Callow*).
[147] *Idem*, para 91.

not breach their duties of good faith pursuant to subsections 4.2(1) and 18.6(1) of the BIA and CCAA, respectively.

6.5.2 *Qualifying under the CCAA*

Unlike a US Chapter 11 proceeding, which is commenced by an electronic filing that creates a limited automatic stay, a CCAA proceeding is commenced by application to court for a single, omnibus initial order that provides the debtor with a comprehensive stay of proceedings and other relief that is generally similar to that relief that would be sought in a Chapter 11 proceeding by way of "first-day" motions.[148]

Proceedings under the CCAA may be commenced for a "debtor company or group of debtor companies". The definition is broad in scope and has been interpreted liberally and purposively by the courts. A debtor company is a Canadian incorporated company or foreign incorporated company with assets in Canada or conducting business in Canada. Any assets, including a bank account in Canada, will be sufficient to meet the technical requirements of the definition.[149] Income trusts (business trusts established for commercial investments) also qualify for relief. Partnerships cannot apply as debtor companies under the CCAA but, pursuant to case law, certain relief such as the stay of proceedings may be extended to partnerships where the corporate partners themselves have filed for CCAA protection and the protection is required to facilitate the restructuring.[150]
A debtor company must:

(1) be insolvent or have committed an "act of bankruptcy" as defined in the BIA; and

(2) have creditor claims against it for at least CAD 5 million, or an aggregate of at least CAD 5 million in debts against a corporate group.[151]

The CCAA does not contain a definition of insolvency; however, courts have held that reference may be had to the definition of insolvency under the BIA. A company will therefore qualify if it is unable to meet its obligations generally as they become due (cash flow insolvency) or has liabilities that exceed the value of assets (balance sheet insolvency). Courts have held that in determining whether a debtor is insolvent for the purposes of the CCAA they may use a "contextual and purposive approach". A debtor may be considered insolvent if the debtor faces a "looming liquidity crisis" or is in the "proximity" of insolvency, even if it is currently meeting its obligations as they become due. It is sufficient if the debtor reasonably anticipates that it will become unable to meet its obligations as they come due before the debtor could reasonably be expected to complete a restructuring of its affairs.[152] In addition, the case law has supported operationally related solvent companies being granted the protection of a CCAA stay where corporate groups have filed.

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[148] www.ontariocourts.ca/scj/files/forms/com/intitial-order-CCAA-EN.doc.
[149] *Re Cadillac Fairview Inc* [1995] OJ No 273 (Ont SCJ).
[150] See note 217 and the *PaylessShoeSource* case.
[151] McElcheran, *supra* note 139, p 242.
[152] See *Re Stelco Inc* [2006], CarswellOnt 4857 and *Lemare Lake Logging Ltd v 3L Cattle Co* [2013], CarswellSask 573.

6.5.3 *Entering CCAA proceedings*

To enter CCAA proceedings, a debtor or any interested person must apply to the court with jurisdiction in the province where the head office or chief place of business of the debtor company is situated; or, if the debtor company has no business in Canada, in any province in which any assets of the company are located.

As noted above, any interested person (that is, not only the debtor) may make an application for an initial stay order under the CCAA. In practice, however, applications are generally made by debtor companies, although creditor driven CCAA proceedings increasingly do occur. There is no requirement for the debtor company to give notice to creditors, employees or stakeholders of its intention to file an initial application. In practice, however, the debtor company generally makes application with the support and knowledge of its secured and / or significant creditors and or stakeholder groups who have participated in the negotiation of the form of initial order requested. The application must be accompanied by a statement indicating the projected cash flow of the debtor company and certain representations of the debtor regarding the preparation of cash-flow projections, a report containing information about the debtor and its operations, and copies of the financial statements from the previous year.[153]

6.5.4 *Qualifying for BIA proposal proceedings*

An insolvent person, a bankrupt, a receiver (in relation to an insolvent person), a liquidator of an insolvent person's property or a trustee of the estate of a bankrupt may make a proposal. An insolvent person is a person who is not a bankrupt and is insolvent on a cash flow or balance sheet basis. Persons include corporations, partnerships and other legal entities.

6.5.5 *Entering BIA proposal proceedings*

The most common route to enter BIA proposal proceedings is filing a Notice of Intention to make a proposal (NOI) with the Official Receiver. Alternatively, the debtor may develop a proposal prior to filing an NOI and file the proposal with a licensed trustee. The trustee then files the proposal with a cash flow statement and associated documents, commencing proceedings.[154] Both routes result in an automatic stay of proceedings against all creditors, secured and unsecured. The trustee must notify all creditors within five days of filing the notice of intention.[155] The debtor is subsequently required to file a cash flow statement and associated documents within 10 days of filing the notice of intention.[156]

6.5.6 *Converting from corporate rescue to liquidation*

Both the CCAA and the BIA permit creditors to apply to the court to terminate the restructuring proceedings if they believe they are being materially prejudiced. The BIA sets out specific grounds for terminating restructuring proceedings, namely (1) lack of due diligence, (2) bad

[153] McElcheran, *supra* note 139, p 252.
[154] Wood, *supra* note 20, p 360.
[155] *Idem*, p 360.
[156] *Ibid*.

faith by the debtor, (3) unlikelihood of a viable proposal being made, and (4) material prejudice to creditors.[157] The grounds under the CCAA are more flexible and discretionary, namely (1) lack of due diligence, (2) bad faith, or (3) "circumstances that make the granting of the order appropriate".[158]

Overall, courts are reluctant to terminate restructuring proceedings and require cogent evidence of material prejudice and that a restructuring is "doomed to failure" and has no prospect of success. The fact that a creditor or group of creditors collectively hold a "blocking vote" and assert they will be unwilling to vote in favour of any plan or proposal, is not necessarily in of itself a valid reason to terminate a CCAA or BIA proposal proceeding prior to a plan or proposal being brought forward. However, lack of support of creditors in combination with a lack of adequate financing and loss of faith in management can cause a court to terminate the proceedings for having no reasonable prospect of success.[159] As discussed above, under the BIA, the failure of the proposal proceedings results automatically in bankruptcy proceedings.

6.5.7 Stay of proceedings under the CCAA

A stay of proceedings is not automatic in a CCAA filing, but is a discretionary order granted as part of the initial order by the court.[160] In practice, initial orders grant a comprehensive stay of proceedings that applies to both secured and unsecured creditors and a stay against termination of contracts with the debtor, including real property leases. The duration of the initial stay is now limited by the statute to 10 days and is subject to renewal by the court once the 10 days have expired at a "comeback hearing".[161] The CCAA also now limits the relief that a company can obtain from the Court during the initial 10 day period to "relief that is reasonably necessary for the continued operations of the debtor company in the ordinary course of business". Similar language limits the amount of DIP (interim) financing that a court can approve at the first day hearing for the 10-day period. Because CCAA proceedings are debtor-in-possession, the stay generally also extends to prevent claims from being initiated or continued against the companies' directors during the period of the stay.

The ultimate duration of stay extensions after the initial 10-day period under the CCAA is entirely within the discretion of the Court and there is no statutory limit on the duration or length of extensions. Some complex restructurings have lasted for multiple years and the stay of proceedings has been extended throughout the proceedings. Under the CCAA, the debtor must satisfy the Court that the stay is appropriate in the circumstances and that the debtor is acting in good faith with due diligence. The scope of the CCAA stay is not defined by the statute but is instead what is provided for in the initial order and is sculpted to suit the specific insolvency issues that the company faces.

There are two significant limitations to the stay: eligible financial contracts such as futures contracts, derivatives and hedging contracts, and regulatory proceedings against the debtor

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[157] BIA, ss 50(12), 50.4(9) and 50.4(11).
[158] CCAA, s 11.02(3).
[159] Wood, *supra* note 20, p 348.
[160] McElcheran, *supra* note 139, p 244.
[161] CCAA, s 11.02(1).

(although fines will be stayed). In addition, no stay of proceedings can have the effect of prohibiting a person from requiring immediate payment for goods and services, or the use of leased (pursuant to a true lease as opposed to financing lease) or licensed property, or require the further advance of money or credit. If a party seeks relief from the stay, they may apply to the court to have the stay lifted. No specific test is contained in the CCAA, but the court will consider the impact of permitting the creditor relief from the stay against the potential success of the restructuring as a whole.[162]

6.5.8 Stay of proceedings in BIA proposal proceedings

A stay of proceedings arises automatically and immediately under the BIA when a proposal is filed with a trustee, or when an NOI is filed with the official receiver.[163] The creation of this automatic stay can be important where exigencies require an immediate stay, but there are strategic or timing reasons why a CCAA application is not feasible as a BIA proposal may be converted into a CCAA proceeding by court order at a later date. Unlike the stay under liquidating bankruptcy proceedings, the BIA proposal stay binds both unsecured creditors and secured creditors. This provision does not apply to secured creditors if they have provided notice of intention to enforce security more than 10 days before the filing of a proposal or a notice of intention to make a proposal. The stay of proceedings also extends to actions against the directors for claims arising before the commencement of proceedings.[164] The stay further provides that no person may terminate an agreement because of the insolvency of the debtor or the filing of the NOI. Landlords cannot terminate leases because of rental arrears. Utilities providers cannot terminate services because of arrears. Creditors can apply to lift the stay on demonstration of material prejudice, or can oppose an extension of the stay if they can demonstrate, among other things, the debtor is not acting in good faith or with due diligence. The stay is also subject to substantially the same limitations as those discussed above in connection with a stay under the CCAA.

The automatic BIA stay is for an initial 30 days and may be extended for additional periods of up to 45 days each, for an aggregate total of up to six months, on findings that the debtor is acting in good faith and with due diligence. If a stay extension is not granted, the debtor is deemed to have made an automatic assignment in bankruptcy. If the restructuring fails, the debtor automatically enters bankruptcy proceedings.[165]

6.5.9 Governance of the debtor during restructuring proceedings

In both BIA proposal and CCAA proceedings, the debtor remains in possession and the usual corporate governance structure remains in place. Directors and officers are often concerned about personal financial liability during insolvency proceedings. In CCAA proceedings it is usual to include a director and officer "charge" with "super-priority" in the initial order to secure indemnity obligations incurred during the restructuring.[166] Provisions in the BIA allow for the

[162] McElcheran, *supra* note 139, p 250.
[163] BIA, s 69 (1).
[164] *Idem*, s 69.31(1).
[165] Wood, *supra* note 20, p 364.
[166] CCAA, s 11.03(1).

court to provide similar protection on notice to secured creditors.[167] As a *quid pro quo* for continuing in management during a CCAA or BIA proposal proceedings, the plan, proposal or final form of court order may include a release of claims that arose against the directors prior to the restructuring process, with the exception of direct contractual claims between creditors and directors, or claims founded on misrepresentation or wrongful or oppressive conduct.[168]

6.5.10 The Monitor in CCAA proceedings

All CCAA orders appoint a Monitor, who is a licensed insolvency professional and an officer of the court, generally selected by the debtor. The Monitor plays a supervisory and advisory role in the proceeding. In its supervisory role, the Monitor oversees the steps taken by the company while in CCAA proceedings as an officer of the court and on behalf of all stakeholders. The Monitor assists with the preparation of the cash-flow statements as well as the negotiation of the plan between the company and its stakeholders. The Monitor also files periodic reports with the court and creditors, including reports setting out the views of the Monitor in connection with any proposed disposition of assets or in connection with any proposed DIP financing. The minimum powers of the monitor are set out in the CCAA, however in appropriate circumstances the monitor's powers may be augmented to exercise more control over the debtor company.[169]

For instance, where the board of directors have resigned or creditors have lost confidence in management, the Monitor's powers can be expanded by the court to allow the Monitor to effectively manage the company during the restructuring. The Monitor can be authorized to sell assets, subject to court approval, and can be authorized to direct certain corporate functions or engage in litigation on behalf of the company. Monitors assuming this role are colloquially referred to as "super Monitors".[170]

6.5.11 The proposal trustee

The proposal trustee is selected by the debtor. Much like the Monitor, the proposal trustee plays a supervisory and advisory role and assists the debtor in the development of the proposal and its negotiations with creditors and other key stakeholders. Under the BIA proposal provisions, a receiver may be appointed in order to take control of management of the company if it is clear that management is no longer acting or capable of acting in the best interests of the company or its stakeholders.[171]

The proposal trustee has a number of statutory duties, including giving notice of the filing of the NOI or the proposal to all known creditors, filing a projected cash-flow statement accompanied by a report from the trustee on its reasonableness, and calling a meeting of creditors to consider and vote on the proposal. At the creditor meeting the trustee is required to report on the financial situation of the debtor and the cause of its financial difficulties. The proposal trustee

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[167] BIA, s 64.1.
[168] McElcheran, *supra* note 139, p 255. See eg CCAA, 5.1(1).
[169] *Idem*, p 264.
[170] Rogers and Huff, *supra* note 26, p 5.
[171] McElcheran, *supra* note 139, p 261.

must also make the final application to the bankruptcy court for approval of the proposal if it is accepted by creditors.

6.5.12 Sales of assets outside the ordinary course of business

Section 65.13 of the BIA, and section 36 of the CCAA, addresses the sale of assets by the debtor outside the ordinary course of business. Particularly in recent years, "liquidating" CCAA and BIA proposal proceedings have grown in popularity. Although developed through case law and the exercise of the court's common law "inherent" jurisdiction to "fill in the gaps" of legislation, under both the CCAA and the BIA the court now has the explicit statutory authority to approve a sale of some or all of the debtor company's assets, free and clear of any security, charge or other encumbrance.[172] The sale can occur during the process either as a means to finance a restructuring of the remaining assets of the debtor company, or as the final creditor-approved outcome of the proceedings. While the courts prefer to see a sale of a business as a going concern, judges may also approve asset sales in a more piecemeal fashion, even where that may have the effect of liquidating the debtor company on an orderly basis.

When deciding whether to approve the sale, the court is required to consider, among other things, whether the process leading to the proposed sale was reasonable in the circumstances, whether the CCAA monitor or proposal trustee approved the process, the level of consultation with creditors, the effect of the proposed sale on creditors and other interested parties and whether the consideration to be received is fair and reasonable, taking into account fair market value.[173] If a sale is to a related person, there is an even higher threshold and the debtor company must show that they made good faith efforts to sell these assets to non-related persons.[174] Although credit bidding (where a creditor bids the value of all or part of its debt) is not statutorily provided for by either the BIA or the CCAA, it has been allowed by the courts as an exercise of their inherent jurisdiction.

Although not statutorily provided for, the courts have also exercised their inherent jurisdiction to allow for auction processes for the purchase of assets through "stalking horse bids" whereby the debtor company enters into an agreement with a potential bidder for the sale of particular assets or the entire business. The stalking horse bidder provides a price that underpins the court sanctioned and controlled auction process. To mitigate against the risk of losing the auction, the stalking horse bidder negotiates compensation for its sunk transaction costs, usually in the form of a "break fee" that it will receive in the event its bid is not successful. It is up to the supervising court to determine and approve the appropriate process.

An alternative to the sale of the assets of the debtor company can include a "reorganization" under equivalent provisions of the CBCA and the provincial corporate statutes that allow companies in CCAA and BIA proposal proceedings to issue new shares of the company to the buyer or investor in exchange for cash, debt or equity securities of the buyer or investor, or a combination.[175] Under these provisions, approval from the debtor company's shareholders is

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[172] CCAA, s 36(1); BIA, s 65.13.
[173] *Ibid*.
[174] CCAA, s 36(4).
[175] See eg CBCA, s 191.

not required – merely approval from the creditors (unless the court orders otherwise, which might happen in the rare case that the existing equity is thought to still have material value).

The meaning of "ordinary course of business" is not defined in either the CCAA or the BIA. In order to determine whether the sale of an asset was done outside of the ordinary course of business the court will take into consideration all of the circumstances and the type of business carried on by the debtor.[176]

6.5.13 Post-commencement financing

A debtor company may require additional funding to continue operations while restructuring proceedings take place under either the CCAA or BIA. This is known as "debtor-in-possession" (DIP) lending. DIP financing may be necessary because the debtor company has previously granted security over all or substantially all of their assets, therefore a debtor company rarely has assets to pledge in order to receive post-proceeding financing.

Prior to the 2009 amendments to the CCAA and the BIA, neither statute dealt with interim financing. To address this issue, the courts began to exercise their inherent jurisdiction to grant orders allowing the debtor to receive interim financing and give priority to the interim lenders over the secured creditors of the debtor.[177] In order to determine whether to provide the debtor with interim financing, the courts considered the extent to which the secured creditors would be adversely affected, examining whether the benefits of the DIP financing clearly outweighed the potential prejudice to creditors.[178] In 2009, both the BIA and the CCAA were amended to specifically address interim financing, codifying the process previously developed by the courts.[179]

The statutory basis for DIP financing under the CCAA is found in section 11.2. The statutory basis for DIP financing under the BIA is found in section 50.6. This section is virtually identical in substance to section 11.2 of the CCAA, with an added provision dealing with individuals. Subsection 50.6(2) provides that an individual may not make an application for DIP financing unless the individual is carrying on a business and that only property related to the business may be subject to a security or charge.

Both the BIA and the CCAA impose three prerequisites to DIP financing: (1) notice must be given to secured creditors who may be affected by the interim financing charge, (2) the amount granted must be limited to the amount that is reasonably necessary for the continued operations of the debtor company in the ordinary course of business, and (3) interim financing cannot be used to secure an obligation that exists before the charge was made.[180] In considering the appropriateness of DIP financing, the court is required to take into account:

(1) the expected duration of the proceedings;

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[176] McElcheran, *supra* note 139, p 309.
[177] *Idem*, p 299.
[178] Wood, *supra* note 20, p 388.
[179] *Ibid*.
[180] *Idem*, p 389.

(2) how the debtor's business and financial affairs are to be managed during the proceedings;

(3) whether the debtor's management has the confidence of major creditors;

(4) whether the DIP loan would enhance the prospects of a viable restructuring;

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

(6) whether any creditor would be materially prejudiced as a result of the DIP priority; and

(7) the monitor / proposal trustee's report on the cash flow forecast.

A number of important principles have come out of court approved super priority DIP financing, including that: DIP financing will be approved if all or substantially all secured creditors consent; DIP financing will be approved where secured creditors are not adversely affected because the financing will result in new collateral to repay the DIP; DIP financing will be approved where the funds are used to pay essential expenditures; and DIP financing will not be approved if there is a reasonable prospect of successful restructuring in another manner.[181]

6.5.14 Provision of essential supplies

The CCAA does not provide statutory priority to suppliers of goods and services to the debtor after the granting of an initial order over pre-filing creditors. Suppliers to the debtor company must continue to supply goods and services during CCAA proceedings on the same terms that existed before the commencement of the CCAA proceedings, but suppliers are not obligated to extend credit to the debtor company during this period and a CCAA stay of proceedings cannot prohibit a person from requiring immediate payment for goods and services.[182] Consequently, suppliers are not compelled under the CCAA to supply goods on credit unless they are declared critical suppliers, discussed in greater detail below. This can create a bargaining dynamic between the suppliers and the debtor company, whereby the suppliers can require cash on delivery (COD) payment for goods and services supplied during the proceedings. Provided the payment for the post-filing supply is made on delivery, the debtor can continue to receive goods under the supplier agreement even though the debtor company is in default of their pre-filing obligations.[183]

There are situations where the debtor company does not have a supply contract but relies on a critical supplier for a unique supply that is crucial to the debtor company's operations. In this situation, the unique critical supplier has the ability to impose unreasonable terms. The CCAA explicitly permits the debtor to apply to the court for an order declaring a person or company a critical supplier and requires the critical supplier to supply the goods on terms that are consistent with the pre-filing supply relationship or what the court considers appropriate.[184] The critical supplier can be provided with a charge over the assets to protect its post-filing supply.

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[181] McElcheran, *supra* note 139, p 302.
[182] *Idem*, p 281.
[183] *Idem*, p 275.
[184] CCAA, s 11.4.

Any application to the court to designate a supplier as a critical supplier must be made on notice to both the supplier and any secured creditors who may be affected by the charge over the debtors assets (if applicable).[185] Supply of utilities can also be effected by power of the court if the court orders a simplified payment structure or security mechanisms for post-filing supply of utilities. Notwithstanding the fact the court cannot order suppliers to continue to supply on credit, the initial CCAA order will generally include a provision of continued power and supply of other utilities.

The BIA does not contain critical supplier provisions. Section 65.1 of the BIA provides that where a notice of intention or a proposal has been filed in respect of an insolvent person, an agreement to supply goods, including utilities, cannot be terminated or amended because of insolvency or because a notice of intention or a proposal has been filed, unless the supplier can demonstrate that the operation of 65.1 would create “significant financial hardship”. The supplier is entitled to demand COD payment for the new goods or services that they continue to supply throughout the stay. No demand is allowed, however, for credit extended prior to the stay period.

6.5.15 Proof of claims by creditors

The CCAA does not contain specific procedures or timelines for determining claims. The claims procedure is determined by the court. CCAA claims orders set a “claims bar date” that requires creditors to file proof of their claim with the monitor within a certain period of time, after which further claims may not be submitted. To prepare, the debtor company generally sends out the amount of the creditor’s claim as per the debtor company’s records. In these cases, the creditor is only required to file a claim if they dispute this amount. Sometimes the monitor is empowered to scrutinize claims on a preliminary basis. “Claims officers” are appointed to act as the claims adjudicators, who have the power to adjudicate the claim.[186] The definition of claim under the CCAA is quite broad, and therefore captures any monetary debts and liabilities owed by the debtor corporation both pre- and post-filing.

The BIA does not create separate claims procedures for liquidating bankruptcy proceedings and restructuring proceedings, therefore the bankruptcy process described in the previous section are the provisions that are used.

6.5.16 Plan of arrangement under the CCAA

A CCAA plan of arrangement is in essence a court-approved contractual agreement between the debtor company and its creditors to compromise the creditors’ legal claims. The CCAA does not dictate the form of the plan, but does insist that payment of certain creditor claims be included, such as government claims as well as wage and pension related claims.[187] Plans of arrangement can take any form, such as a debt for equity swap, the compromise of debt, the issue of new debt instruments, etc. A successful plan will provide the creditor with recovery of a

[185] McElcheran, *supra* note 139, p 276.
[186] *Idem*, p 336.
[187] *Idem*, p 332.

quantum or nature that is a material improvement over what they could expect in a liquidation scenario.

Although there are no strict rules regarding how the classes are determined, creditors must have some common interest within their class. For the plan to be binding on each class of creditors, a majority of the proven creditors in that class, by number, together with two-thirds of the proven creditors in that class, by dollar value, must approve of the plan presented to them. If a class of creditors approves the plan, it is binding on all creditors within the class, subject to the court's approval of the plan. Given this threshold, a single large creditor holding more than one-third of the total debt in the class may defeat a plan.

If all of the classes of creditors approve the plan by the requisite majorities, the debtor must apply to the court for it to be sanctioned. In order to be approved by the court the plan must be in strict compliance with statutory criteria, there must be no unauthorized conduct and the plan must be one that is "fair and reasonable".[188] In practice the court will consider, among other things, the level of creditor support for the plan, what creditors would have received on bankruptcy or liquidation as compared to the plan, and whether there has been any oppression of the rights of creditors.[189] Once the plan has been sanctioned by the court it is binding on the debtor company and all affected creditors, including dissenters.

If a class of creditors or the court does not approve the plan, the company does not automatically go into bankruptcy, but the stay may be lifted and it is likely that the company will be placed into receivership or bankruptcy. In practice a plan will not be brought forward in a complex restructuring for a vote unless it enjoys support form key creditors or creditor groups.

6.5.17 Proposal under the BIA

A proposal under the BIA is similarly simply a contractual, court-approved compromise between a debtor and its creditors. Once a proposal is filed, the trustee must call the meeting within 21 days from the filing of the proposal with the official receiver. The BIA also stipulates that the proposal must be approved by a majority of the proven creditors in that class, by number, together with two-thirds of the proven creditors in that class, by dollar value, of each class of creditors that is affected by the proposal. Again, given this threshold, a single large creditor holding more than one-third of the total debt in the class may defeat a plan. The BIA provides statutory criteria for court approval of a proposal. The court must refuse a proposal if the terms of the proposal are unreasonable or the terms of the proposal are not calculated to the benefit of the general body of the creditors.[190] The courts have also developed the standard that the proposal must be made in good faith.[191]

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[188] Wood, *supra* note 20, p 490.

[189] *Re Canadian Airlines Corp,* [2000] AJ No 711 at para 96, leave to appeal refused, [2000] AJ No 1028 (Alta CA), affd 2001 ABCA 9 (Alta CA), leave to appeal refused [2001] SCCA No 60.

[190] *Idem*, p 491.

[191] BIA, s 4.2(1); see *Re Kitchener Frame Ltd,* 2012 ONSC 234 at para 19.

In both BIA and CCAA proceedings, it is possible to conclude a sale of assets of the debtor, including a sale of substantially all of the assets of the debtor, without the necessity of awaiting a formal BIA Proposal or CCAA Plan, provided there is broad creditor support.

As previously stated, there are no "cram-down" provisions under either the BIA or the CCAA. Depending on perspective, this can be an advantage in that it requires a more consensual negotiation process, or a disadvantage, as it incentivizes groups with blocking votes to take aggressive positions.

6.5.18 Set-off

The CCAA preserves set-off rights and they are considered a substantive defence to a claim. Since set-off is a defence, the court has no discretion to order persons entitled to set-off to pay money they do not owe to the debtor company because of a valid right of set-off.[192] The CCAA does not prescribe the time for determining set-off, unlike the BIA which dictates that rights of set-off are determined as of the date of bankruptcy. Under the CCAA, legal set-off only arises if the following factors are present: the obligations are liquidated; the obligations are mutual; and the obligations are due.[193]

In a CCAA proceeding, the initial court order may temporarily restrain the exercise of rights of set-off. Set-off will, however, be recognized and permitted for the purposes of creditors' claims in a CCAA plan. As discussed above in the section on bankruptcy, valid set-off claims are expressly preserved in the BIA.[194] Both the BIA and CCAA contain special provisions that expressly permit netting of particular types of financial contracts such as swaps, repurchase agreements and commodity contracts.

6.5.19 Treatment of executory contracts

Under Canadian restructuring practice there is no necessity for a reorganizing debtor to adopt executory contracts; they remain in force unless otherwise disclaimed.

6.5.20 Disclaiming onerous contracts

Sections 65.11 of the BIA and 32 of the CCAA allow for disclaimers of most types of agreements by delivering a prescribed notice pursuant to a prescribed form under the Acts. These provisions specifically exclude contracts entered into after the date proceedings began, a financing agreement if the company is the borrower, commercial leases where the debtor is the lessor, eligible financial contracts, and collective bargaining agreements (union contracts). Disclaimer requires monitor / proposal trustee approval or, alternatively, court approval. In either scenario, when the court hears an application regarding disclaimer, they will consider, among other things: whether the monitor or proposal trustee approved the disclaimer, whether the disclaimer would enhance the prospects of viable compromise and whether the disclaimer

[192] McElcheran, *supra* note139, p 272.
[193] *Idem*, p 271.
[194] BIA, s 97(3).

would likely cause significant financial hardship to a party to the agreement.[195] On disclaimer the counterparty can make a claim in the insolvency proceeding for damages resulting from the disclaimer. If the debtor has granted an intellectual property licence, any disclaimer by the debtor does not affect a licensee's ability to use the intellectual property or benefit from a right to exclusive use over the term of the licence, as long as the licensee continues to perform its obligations.

6.5.21 Assigning contracts

Both the BIA and the CCAA allow for the assignment of contracts, notwithstanding that the agreement contains a restriction on assignment.[196] These provisions specifically exclude contracts entered into after the date of bankruptcy, commercial leases, eligible financial contracts, collective bargaining agreements, and agreements that are not assignable by reason of their nature, such as personal services contracts. The approval of the monitor or proposal trustee is required for any assignment. Before effecting the assignment of the debtor's rights under a contract, the court will consider factors such as (i) the ability of the assignee to perform the obligations and (ii) the appropriateness of the assignment of the rights and obligations. The court may not order the assignment unless all monetary defaults are remedied by a date fixed by the court.

6.5.22 Impeachable transactions

The CCAA states that unless the plan of arrangement provides otherwise, the provisions in the BIA dealing with preferences and transfers at undervalue govern CCAA restructuring cases. For the purposes of the CCAA, the day the proceedings commenced is considered the "initial bankruptcy event", the monitor replaces the trustee, and any references in the BIA to the bankrupt are replaced with the "debtor company".[197]

6.5.23 Priorities

Under the CCAA, the court typically grants super-priority charges which rank ahead of secured creditors for certain claims. These super-priority charges often include:

(1) fees for professionals such as the Monitor and its counsel, fees for counsel to the company and fees for other restructuring professional such as a chief restructuring officer (administrative charge);

(2) DIP financing charge; and

(3) amounts to pay post-filing critical suppliers to the company.

The CCAA does not contain a statutory scheme for distribution. However, the BIA scheme of liquidation and distribution supplies the backdrop for distribution if a CCAA reorganization is

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[195] McElcheran, *supra* note139, p 284.
[196] BIA, ss 65.11, 66 (1.1), 84.1 and 146 and Bankruptcy and Insolvency General Rules, ss 94.1 and 95 and Form 44.1.
[197] McElcheran, *supra* note 139, p 354.

ultimately unsuccessful and a company is liquidated under the CCAA. In a liquidating CCAA, the Supreme Court has accepted that the BIA and CCAA form part of "an integrated body of insolvency law" and, while the CCAA does not explicitly provide for an automatic transition to the liquidation provisions of the BIA, "the breadth of the court's discretion under the Act is sufficient to construct a bridge [from a failed CCAA reorganization] to liquidation under the BIA".[198]

By contrast, in "true" restructuring CCAA proceedings, creditors are free to compromise the priorities of all or part of their claims as between themselves as part of a plan or proposal, subject to specific statutory restrictions on claims that may not be compromised (such as Crown and employee priorities) and the general oversight of the court approving the plan or proposal, which will consider among other things the support for the plan or proposal, what creditors would have received on bankruptcy or liquidation as compared to the plan or proposal and whether there has been any oppression of the rights of creditors.

As a result, while in practice the BIA liquidation priority scheme is generally followed in CCAA and BIA proposal proceedings, each insolvency remedy has its own distinct purpose and process. When there is no plan in the context of a liquidating CCAA, it is common sense that the BIA liquidation priority regime should govern. However, due to the restructuring focus of these mechanisms and the discretion afforded to judges, it does not follow that all priorities in bankruptcy will necessarily be upheld in CCAA restructurings or BIA proposal proceedings.[199]

6.5.24 Debt restructuring under the CBCA

Increasingly, corporations are turning to the CBCA to restructure under the plan of arrangement provisions in section 192. Restructuring through a corporate statute as opposed to an insolvency statute is attractive to corporations in the proper circumstances due its flexible interpretation and the broad discretion exercised by the courts.[200] Section 192 of the CBCA may be used by corporations that do not require operational restructuring but instead only a restructuring of their assets and liabilities. For example, if a corporation is indebted to its stakeholders it may negotiate a cash infusion from a third party in exchange for equity, contingent on approval of the plan by the courts under the CBCA.[201]

Implementing a plan of arrangement under section 192 begins with an application by the corporation for an interim order, followed by an application for a final order once the process is complete. The first thing the court considers is whether the statutory requirements under section 192 have been met, which are:[202]

(1) notice must be provided to the CBCA Director;

198 *Century Services Inc v Canada* (Attorney General), [2010], 3 SCR 379.
199 *Sun Indalex Finance LLC v United Steelworkers*, 2013 SCC 6 at 51.
200 S Zweig and P K Bell "The Expanded Use of the CBCA in Debt Restructurings", *Annual Review of Insolvency Law 2018*, Thomson Reuters, p 1 (hereinafter referred to as Zweig and Bell).
201 See, eg, *Trizec Corp, Re* [1994], 10 WWR 127 ABQB.
202 Zweig and Bell, *supra* note 200, p 3.

(2) the proposed arrangement must constitute an "arrangement" under section 192 of the CBCA;

(3) it is not practicable to effect the proposed arrangement under any other provision of the CBCA; and

(4) the applicant is not "insolvent".

The case law suggests that the statutory requirements are rarely a significant hurdle to applicants. An "arrangement" is broadly defined under the CBCA and is inclusive of many different structures, such as an amendment to the articles of a corporation, an amalgamation or a transfer of securities. As long as an aspect of the arrangement falls into one of the listed categories in section 192 of the CBCA, the court is generally satisfied that the plan may be classified as an arrangement.

Impracticability is addressed in the Director's Policy Statement, which states that the applicant may satisfy this requirement if they establish that it would be "inconvenient or less advantageous to the corporation to proceed under other provisions of the CBCA".[203] The courts general concern is to the efficiency offered by the arrangement.

Finally, section 192 of the CBCA states that the applicant must be solvent. At the interim order stage, the case law indicates that the court will approve the application if at least one of the applicant companies is not insolvent.[204] At the final order stage, the court must conclude that the corporate entity that emerges, once the plan of arrangement is implemented, will not be insolvent. What this means in practice is that while applicants are able to skate by the solvency requirement at the interim order stage with a newly incorporated shell company, they must be seeking to implement a plan of arrangement that will result in a solvent entity on the other end.

The second requirement for court approval of the arrangement under section 192 is that the application being put forward must be in good faith. Generally, this requirement is easily satisfied if it can be demonstrated that the applicant has a valid business purpose for putting forward the arrangement.

The last requirement for court approval under section 192 is that the arrangement must be fair and reasonable in the circumstances. The court considers the positive benefits to the corporation which flow from the valid business purpose established under the second requirement of section 192. The necessity of the arrangement for the future success of the corporation is often an important factor.[205] At this stage, the court must also consider any objections by stakeholders and whether those objections can be resolved in a fair and balanced manner. For example, the court may consider whether the arrangement has been approved by

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[203] *Idem*, p 5. See Industry Canada, Policy on Arrangements-Canada Business Corporations Act, s 192 (Ottawa: IC, 8 January 2014) at s 2.06.
[204] Zweig and Bell, *supra* note 200, p 5.
[205] *Idem*, p 6.

the majority of the security holders, or whether an informed and reasonable business person would approve the plan.[206]

The use of section 192 of the CBCA is an effective mechanism used by corporations to restructure outside of the insolvency process. It has an immediate benefit to corporations and is considered more cost efficient in scenarios that meet the requirements laid out above.

Self-Assessment Exercise 4

Question 1

Describe debtor-in-possession (DIP) financing and why it is necessary when a company is restructuring.

Question 2

What are the advantages of using the CBCA to restructure the debts of a federal company? Is this an appropriate mechanism to use where an operational restructuring is necessary?

Question 3

Could a debtor company sell part of its assets in CCAA or BIA proposal proceedings on a liquidation basis to fund the proceedings while it considered further going concern or liquidation assets sales? If so, what factors would the court look at when considering whether to approve such sales?

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

7.1 Canada's approach to cross-border insolvency law

Like all countries, Canada has implemented insolvency laws and procedures that reflect particular national policy objectives and perceptions of the way the loss caused by insolvency should be shared between creditors and other stakeholders and how the process for administering that process should be run. Canadian creditors and stakeholders order their affairs and base their expectations on this national insolvency law framework. The Canadian insolvency law system is "universalist" in that it purports to extend to the debtor's assets wherever located. It is reciprocal in that it permits foreign creditors to participate in Canadian insolvency proceedings with the same rights and priorities as similarly situated domestic creditors. Often, however, companies or corporate groups that become insolvent carry on

[206] *Idem*, p 6-7. Please see *Re Stelco* [2006], OJ No 593 (ONSC) at para 12.

business and have assets and claims in multiple jurisdictions, each with their own set of national laws, some of which may conflict substantively with Canadian insolvency law. The Canadian system is only beneficial if other states respect properly initiated Canadian insolvency proceedings and recognize the rights of Canadian creditors in their proceedings. It should also be kept in mind that despite its imposingly large land area, Canada has a relatively small population and unimposing economy and military. It cannot simply impose its will on other countries.

These issues are particularly acute due to Canada's close proximity to the US and the sheer volume of trade between the countries. Canada has approached the challenges posed by cross-border insolvency pragmatically on the basis of "modified universalism", accepting that concurrent insolvency proceedings in multiple jurisdictions will sometimes be necessary, but that the best means for a fair and efficient outcome is for courts to coordinate their efforts and respect each other's processes and orders to the extent possible. Overall, Canadian judges retain a high degree of discretion to employ the statutory provisions on the recognition of foreign proceedings in a way that accords with this underlying policy rationale in individual circumstances.[207] As a result, Canadian courts have, for the most part, faced the challenge of managing cross-border insolvency proceedings effectively and flexibly and have been quick to adopt the principles of comity and cross-border cooperation. To date, Canadian courts have enthusiastically embraced cross-border recognition orders, court-to-court communication, the use of cross-border insolvency protocols, coordinated assets sales and coordinated restructuring plans.

7.2 Adoption of modified version of the UNCITRAL Model Law

Through the 2009 amendments to the BIA and CCAA, Canada adopted a modified version of the UNCITRAL Model Law in Part XIII of the BIA[208] and a new Part IV of the CCAA.[209] These sections of the BIA and CCAA contain substantially similar provisions that provide a framework for recognition of foreign insolvency proceedings and acceptance of jurisdiction.

By way of review, the principles of the Model Law are two-fold. The first is the mandatory recognition of foreign insolvency proceedings (unless manifestly contrary to public policy) and the second is classification of the foreign proceeding of each debtor entity as either a "foreign main proceeding" or a "foreign non-main proceeding".[210] The mandatory recognition of foreign proceedings is intended to facilitate judicial cooperation between countries and provide access to domestic courts for foreign representatives. Classifying the proceeding as either the foreign main proceeding or the foreign non-main proceeding is intended to determine the level of control the foreign court may assert over the administration of the insolvency proceedings. A high level of deference is afforded to the court administering insolvency proceedings. Accordingly, if a foreign main proceeding is recognized, all proceedings in the recognizing jurisdiction must be stayed.[211]

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[207] Wood, *supra* note 20, p 600.
[208] BIA, s 267-284.
[209] CCAA, s 44-65.
[210] McElcheran, *supra* note 139, p 397.
[211] *Ibid*.

There are several provisions of the Model Law that are substantially similar to the provisions enacted in the BIA and CCAA, including those that concern applications and orders for recognition of a foreign main proceeding or a foreign non-main proceeding. Coordination of domestic and foreign proceedings and concurrent foreign proceedings are replicated from the form of the Model Law directly into the BIA and CCAA.[212] Additionally, appointments of persons by the Canadian court to represent Canadian proceedings outside of Canada for recognition by other foreign courts, occurs under the BIA and CCAA in virtually the same manner under the Model Law. Lastly, Canada has chosen to adopt the "hotchpot rule" in cross-border proceedings.[213] The rule applies where there are concurrent proceedings in both Canada and another country and allows for a dividend or distribution of property that is received by a creditor in a foreign insolvency proceeding to be taken into account in a Canadian insolvency proceeding.[214]

There are 12 provisions of the Model Law Canada chose not to adopt. These include: article 3 (conflicting treaty obligations); article 4 (court or other authority competent to deal with recognition of foreign proceedings); article 6 (public policy exceptions); article 8 (interpretation of the Model Law); article 9 (foreign representative's right of direct access to courts of forum state); article 11 (application by foreign representative to commence proceedings under the law of the enacting state); article 13 (access of foreign creditors to proceedings under the law of enacting state); article 14 (notification to foreign creditors of proceedings under the law of the enacting state); article 22 (protection of interests of creditors and other interested parties); article 23 (avoidance of acts detrimental to estate); and article 24 (intervention by foreign representative in domestic proceedings in forum state).[215]

Lastly, there are number of provisions that are considerably different than the Model Law or have no Model Law counterpart. The definition of "foreign non-main proceeding" differs substantially from the Model Law. The Model Law requires the debtor to have an "establishment" in the place of the foreign proceedings, meaning somewhere the debtor carries on economic activity. The BIA and CCAA do not have this requirement and simply states that a foreign non-main proceeding is a foreign proceeding other than a foreign main proceeding.[216] Additionally, the BIA and CCAA allow a foreign representative, once a recognition order is made, to commence or continue proceedings under the BIA or CCAA as if the foreign representative were a creditor of the debtor company or the debtor company itself (in other words, commence BIA or CCAA proceedings).[217] This has no counterpart in the Model Law and arguably reflects a partiality to "Canadian" proceedings. There is also a section in both the BIA and the CCAA that states that nothing prevents the court, on application of a foreign representative or another interested party, from applying any legal or equitable rules governing the recognition of foreign insolvency orders and assistance to foreign representatives that are not "inconsistent with the provisions of the BIA or CCAA".[218] The Model Law does not contain a similar section, largely due to the fact

[212] BIA, s 275 and CCAA, s 52.
[213] McElcheran, *supra* note139, p 409.
[214] Wood, *supra* note 20, p 618.
[215] Duggan *et al*, *supra* note 22, p 296.
[216] BIA, s 268 and CCAA, s 45.
[217] BIA, s 274 and CCAA, s 51.
[218] BIA, s 284 and CCAA, s 61.

that this provision allows the courts to utilize the provision in its discretion to bypass the procedure structured in the Model Law.[219]

7.3 Jurisdiction

As previously discussed, the definition of "debtor" and "insolvent person" under the BIA and "company" under the CCAA are broad enough to encompass foreign registered corporations or domiciled individuals who do business in or have property or assets in Canada.[220] Given the flexibility of the jurisdictional tests, Canadian courts will in appropriate circumstances be prepared to exercise jurisdiction despite remote connections between the debtor and Canada. These broad and flexible definitions give the Canadian court the discretion to accept jurisdiction and provide recognition and assistance where appropriate and necessary, such as where the members of an insolvent group of companies seek protection through a coordinated filing, but individual members of the group may not directly have assets in Canada.

7.4 Process for recognition

The provisions of the BIA and CCAA on the recognition of foreign insolvency proceedings require Canadian courts to recognize foreign proceedings on formal proof of three main requirements:

(1) that the proceeding is a "foreign proceeding" in accordance with the statutory definition;

(2) that the applicant is a "foreign representative" in accordance with the statutory definition; and

(3) whether the "foreign proceeding" is a "foreign main proceeding" or a "foreign non-main proceeding" based on a center of main interest (COMI) analysis.[221]

The recognition application is commenced by a foreign representative who files sufficient evidence of the foreign law to allow the Canadian court to determine that they are a foreign representative and the proceeding is a foreign proceeding.[222] The case law demonstrates that both terms are to be given a broad and purposive interpretation, thereby allowing an applicant to meet the requirements for recognition of a foreign proceeding without difficulty. The focus of the Canadian court is on the substance of the foreign law rather than its nomenclature.

Once the requirements for recognition have been met, the recognition is automatic and compulsory, similar to the Model Law: the court must make an order recognizing the foreign proceeding. If the court determines the foreign proceeding is a foreign main proceeding, the

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[219] Duggan *et al*, *supra* note 22, p 300.

[220] Although the CCAA definition of "debtor company" does not include partnerships, the courts have established that a stay of proceedings granted in favour of (separate) applicant(s) may be extended to cover partnerships where they are "significantly interrelated" to the applicant(s)' business and are an "integral part of its operations" (see *Payless Shoesource Canada,* 2019 ONSC 1215, at para 26).

[221] BIA, s 269-272 and CCAA, s 46-49.

[222] McElcheran, *supra* note 139, p 401.

court will automatically issue a stay of proceedings. If it determines that the proceeding is a foreign non-main proceeding a stay may be requested, but the court exercises discretion to make any order necessary for the protection of the debtor's property or the interests of creditors.

7.5 Centre of main interests

There is no statutory definition of COMI in either the CCAA or the BIA, however each statute contains a rebuttable presumption. In the case of an individual, the COMI, in the absence of proof to the contrary, is the debtor's ordinary place of residence. In the case of a company, the COMI, in absence of proof to the contrary, is the company's registered office.[223] The courts have identified the following three considerations, considered as a whole, are of primary importance for determining COMI:[224]

(1) the location that significant creditors recognize as being the centre of the company's operations;

(2) the location in which the debtor's principal assets or operations are found; and

(3) the location of the debtor's headquarters, head office or "nerve centre".

Once the COMI is determined, the foreign proceeding is either classified as the foreign main proceedings, if it is where the COMI is located, or the foreign non-main proceeding, if it is not where the COMI is located. In either case, there are effects that stem from the recognition.

7.6 Legal effect of recognition

If a foreign proceeding is recognized as the foreign main proceeding, an automatic stay of proceedings occurs in Canada.[225] If a foreign proceeding is recognized as a foreign non-main proceeding, a stay may still be obtained, but it must be requested and justified. If a foreign proceeding is recognized, as either main or non-main, it gives the foreign representative standing to appear and be heard in Canadian courts.[226] Furthermore, the recognition imposes an obligation on Canadian officials to cooperate with the foreign representative and the foreign court. Both the BIA and the CCAA contain broadly worded, discretionary provisions that provide that where an order recognizing a foreign proceeding has been made the court may, on application by the foreign representative, if it is satisfied that it is necessary for the protection of the debtor companies property or the interests of a creditor or creditors, make "any order that it considers appropriate".[227] This includes, but is not limited to, orders respecting the examination of witnesses and the taking of evidence, and provision of information on the debtor's property and affairs. Subject to the public policy exception discussed below, and

223 BIA, s 268 and CCAA, s 45.

224 See in *Re Mt Gox* [2014], ONSC 5811. See also *Re Massachusetts Elephant & Castle Group Inc (2011),* 81 CBR (5th) 102 (Ont SCJ) and *Re Lightsquared* LP, 2012 CarsewellOnt 8614 (Ont SCJ (Commercial List)) and *Re Caesars Entertainment Operating Co,* 2015 CarswellOnt 3284 (Ont SCJ) for application of the same principles under the CCAA.

225 BIA, s 271 and CCAA, s 48.

226 CCAA, s 49(1).

227 BIA, s 272(1) and CCAA, s 49(1).

ensuring that any such order is consistent with orders made in any concurrent proceedings under the BIA or CAA,[228] the court is not restricted in exercising this discretion to only to providing the same or similar remedies as are available under Canadian insolvency law and has in fact ordered relief in foreign-main proceedings where there are ancillary Canadian proceedings that would not ordinarily be available in Canadian proceedings.[229]

7.7 Public policy exemption

Both the BIA and the CCAA contain a public policy exception which permits the court to "refuse to do something that would be contrary to public policy" when implementing the cross-border insolvency provisions.[230] This public policy exemption allows the courts to refuse to act even if the particular foreign proceedings meet the recognition requirements under either the BIA or the CCAA. Generally, Canadian courts are inclined to recognize foreign insolvency proceedings, especially those that are initiated in common law jurisdictions where Canada has strong economic ties and Canadian courts have familiarity with the legal system, such as the US or the UK and are generally reluctant to employ the public policy exception absent clear circumstances that offend Canadian public policy.[231] In practice the exemption appears to only have been employed where there is asymmetrical or unfair treatment of Canadian creditors specifically.

7.8 Relevant case law

There is not yet a substantial body of law interpreting Part XIII of the BIA and Part IV of the CCAA, but the case law that has interpreted the provisions confirm the willingness of Canadian insolvency courts to recognize principles of international judicial cooperation and comity in the context of foreign insolvency proceedings that may impact stakeholders in Canada. This is particularly true in the case of Chapter 11 cases, which are routinely recognized in Canada.

7.8.1 Comity

Morguard Investments Ltd v De Savoye[232] (discussed in more detail further *infra*) is the pre-eminent Supreme Court of Canada case that recognizes the importance of comity in the context of globalization. The court concluded that comity is an idea based not only on respect between sovereign states, but is also necessary for the reciprocal flow of communication and skill in the modern world. Meaning that courts are likely to implement foreign recognition orders on the basis that they would also like Canadian judgements to be enforced abroad and generally prefer

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[228] In *Nishiyama* (2020 BCSC 224), the court held that the order-making powers under s 272(2) grant the court jurisdiction to make the enumerated kinds of orders *in the jurisdiction of the foreign main proceeding* where "necessary" and "appropriate" to do so once a foreign proceeding is recognized (here, the Japanese proceedings were recognized as foreign main proceedings) – see para 48. This is novel because the statute does not specify the jurisdiction in which these orders may apply. The court noted that s 272(1) of the BIA had not been judicially considered prior to this case. Note that the "necessity" element was clearly made out in this case, as the target of the examination order was legally prohibited from leaving Japan and therefore could only be examined there – see para 51.

[229] *Re Hartford Computer Hardware Inc*, 2012 ONSC 964.

[230] BIA, s 284(2) and CCAA, s 61(2).

[231] *Re Hartford Computer Hardware Inc*, *supra* note 229.

[232] [1990] 3 SCR 1077.

not to exercise the public policy exemption. The court, in *Hollander Sleep Products*, recently described comity as "the central principle governing Part IV of the CCAA",[233] noting that Canadian courts have emphasized the importance of comity in cross-border insolvencies in the service of avoiding "multiple proceedings, inconsistent judgments and general uncertainty".[234]

7.8.2 Recognition

In *Centaur Litigation SPC, Re*,[235] a Cayman's liquidator successfully brought an application for an order that proceedings commenced in the Cayman Islands be recognized as a foreign main proceeding. In concluding that the definition of "foreign proceeding" was met, the Court held that "the Cayman proceeding is a judicial proceeding in a jurisdiction outside Canada dealing with the creditors' collective interests generally under the Cayman Islands Companies law, which permits insolvent companies to restructure under the supervision of the court". This case illustrates the broad and purposive approach Canadian courts will take to the recognition of foreign proceedings, focusing on the substance of the foreign law.[236]

A recent example of a court recognizing a foreign non-main proceeding is the *Syncreon*[237] case. There, the applicant sought to have UK scheme of arrangement proceedings involving a large enterprise group of over 60 debtor companies recognized in Canada as a foreign non-main proceeding. A subset of these companies were involved in the scheme of arrangement (the "scheme companies"). As a part of the scheme, Syncreon Canada – a Syncreon entity but not a scheme company – was to receive the benefit of releases regarding guarantees it had provided in respect of Syncreon BV's debts, which made up substantially the entire scheme debt.

The court recognized the foreign proceeding (being satisfied that the application related to a foreign proceeding and the applicant was a foreign representative) and determined that it was a **non-main** proceeding on the basis that the **key scheme company** had its COMI outside the UK (the jurisdiction in which proceedings were commenced) – the key company in this case being Syncreon BV as the central debtor under the scheme. Since Syncreon BV was Dutch company, its COMI fell outside the UK and therefore the Ontario Superior Court recognized the scheme of arrangement proceedings in Canada as foreign non-main proceedings.

7.8.3 COMI

In *Re MtGox Co*,[238] the Ontario court applied the provisions of Part XIII of the BIA to recognize Japanese bankruptcy proceedings for MtGox Co Ltd in Canada as a foreign main proceeding. MtGox was one of the largest Bitcoin exchanges in the world. At the beginning of 2014, MtGox halted all withdrawals of Bitcoins, claiming that it lost 850,000 Bitcoins in a hacking attack. MtGox subsequently filed a petition for a civil rehabilitation proceeding in Tokyo, which is analogous

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[233] 2019 ONSC 3238 at para 41.
[234] *Idem*, para 42.
[235] [2016] BCSC 1224.
[236] For a more recent illustration, see *Syncreon* (2019) ONSC 5774 (Commercial List).
[237] *Ibid*.
[238] [2014] ONSC 5811. See also *Re Massachusetts Elephant & Castle Group Inc (2011),* 81 CBR (5th) 102 (Ont SCJ) and *Re Lightsquared* LP, 2012 CarsewellOnt 8614 (Ont SCJ (Commercial List)) and *Re Caesars Entertainment Operating Co,* 2015 CarswellOnt 3284 (Ont SCJ) for application of the same principles under the CCAA.

to restructuring proceedings available to debtors in Canada. The Tokyo District Court dismissed the civil rehabilitation petition and commenced bankruptcy proceedings, appointing a bankruptcy trustee. Following the bankruptcy, Canadian investors launched a CAD 500 million class action against MtGox alleging negligence, breach of contract and fraud. In response, MtGox's bankruptcy trustee sought recognition of the Japanese bankruptcy proceeding in Ontario as a foreign main proceeding. Recognition would result in a stay of all actions brought against the company in Canada, including the class action.

The court determined that the bankruptcy proceedings in Japan fell under the definition of "foreign proceeding" because the Japan bankruptcy proceedings were a judicial proceeding dealing with the creditors' collective interest under the Japan Bankruptcy Act. In addition, the Court also determined that the trustee met the two-part definition of "foreign representative" because: (a) the trustee had the authority, pursuant to the Japan Bankruptcy Act and the bankruptcy order made by the Tokyo District Court, to administer MtGox's property and affairs for the purpose of liquidation, and (b) the trustee had the authority to act as a representative in respect of the foreign proceeding.

The court further held that the Japan bankruptcy proceedings were a foreign main proceeding. In determining MtGox's COMI was in Japan, the court considered the following factors, among others: (i) the location is readily ascertainable by creditors, (ii) the location is one in which the debtor's principal assets and operations are found, and (iii) the location is where the management of the debtor takes place.

A number of relevant facts supported a finding that MtGox's COMI was in Japan, including (i) that MtGox had no assets or offices in Canada, (ii) that MtGox was and always has been organized under the laws of Japan, (iii) the registered office and books and records of MtGox were in Japan, (iv) the sole director of MtGox resides, and at all relevant times had resided, in Japan, (v) most of MtGox's bank accounts are located in Japan, (vi) MtGox's parent corporation supplied services to it in Japan, (vii) the MtGox website clearly disclosed that it was a Japanese corporation located in Japan, and (viii) MtGox was investigating the hacking that occurred against it under the oversight of the Tokyo District Court.

7.8.4 Public policy

In *Re Hartford Computer Hardware Inc*,[239] the Ontario Superior Court of Justice (Commercial List) granted a recognition order pursuant to the CCAA which, among other things, approved a "Final DIP Facility" containing a partial "roll up" provision whereby the prepetition lenders provided DIP financing that effectively paid off (or "rolled-up") the prepetition secured debt. This provision would likely be prohibited in a CCAA proceeding (as opposed to a foreign main proceeding) pursuant to section 11.2 of the CCAA, which provides that an interim financing charge in favour of a DIP lender may not secure an obligation that exists before the initial order is made. In granting this order, the court reviewed the public policy exception outlined in section 61(2) of the CCAA and determined that the exception ought to be interpreted in a restrictive manner, consistent with the Guide to Enactment of the UNCITRAL Model Law on Cross-Border

[239] [2012] ONSC 964.

Insolvency. The court focused on the status of the proceeding as a foreign main proceeding, the fact the US court had granted the relief as necessary to the restructuring, and the lack of specific material prejudice or differentiation in the treatment of Canadian creditors.

A rare example where Canadian courts chose to refuse to grant a recognition order on the grounds of public policy was the pre-2009 amendment case of *Canadian Imperial Bank of Commerce v ECE Group Ltd*.[240] The court was asked to implement a recognition order of a liquidation proceeding commenced in the US by insurance companies attempting to escape liability arising in Ontario. In rejecting the recognition, the judge noted that Canadian courts are strong supporters of comity and the recognition of foreign orders, but the existence of comity is not limitless and comity must not be exercised at the expense of injustice to the country's citizens. The judge determined that granting the stay would be unfairly prejudicial to the Canadian insurance companies. At the time the motion for the stay was brought, it was unclear as to the amount of insurance proceeds which were available in the dispute. Due to the lack of information the judge concluded that granting the stay would be a premature exercise. The *ECE Group* case provides for an important example of a public policy case where the court refused to recognize a foreign order on the basis that it may be unduly prejudicial to Canadian creditors.

While not strictly a matter of the public policy exception, Canadian courts seek to prevent undue prejudice to non-Canadian creditors as well: in *Purdue*,[241] the court declined to exclude a Canadian creditor from a temporary stay of proceedings order made by a US court after deciding that the order should be recognized in Canada (with the position of this single Canadian creditor being the central issue). In so declining, the court made clear that, if it did not grant the stay in Canada and apply it to all Canadian creditors, "Canadian Creditors will have an advantage over US creditors by continuing to pursue their actions against Related Parties here while US claimants are at a standstill. This will result in an uneven playing field among stakeholders which is exactly what a stay of proceedings against third parties is intended to prevent".[242]

7.8.5 Corporate groups

The BIA and the CCAA do not specifically address the issue of corporate group insolvencies where parent and subsidiary companies are involved across territorial borders in insolvency proceedings. In these scenarios, each corporation will have different debts and obligations, and may have different registered offices, making it difficult to determine COMI and to distribute the assets of each corporation to interested parties. Note also that, for corporate groups, the COMI to be assessed is that of the "key" company to the particular recognition proceedings, not necessarily the parent or flagship company of the group.[243]

In Canada, procedural consolidations are commonly used to address domestic corporate group insolvencies.[244] Procedural consolidation occurs when one or more members of the group are

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[240] [2001] CarswellOnt 463.
[241] [2019] ONSC 7042.
[242] *Idem*, para 24.
[243] *Syncreon, supra* note 236.
[244] Duggan *et al*, *supra* note 22, p 280.

joined in the same insolvency proceedings for administrative convenience, while maintaining a separate identity for other purposes, such as distribution of assets.[245] This differs from the practice of substantial consolidation, which involves a pooling of assets and the claims against the parent and subsidiary corporations so that the joint assets of the related companies are used to satisfy the claims of all the creditors. Substantial consolidation has a major effect on the claims of creditors and therefore is not readily preferred in the Canadian context.[246]

There are no specific rules in either the BIA or the CCAA that govern the determination of COMI when Canadian entities are part of a corporate group with international operations. The decision of the Ontario Superior Court of Justice in *Re Massachusetts Elephant & Castle Group, Inc*[247] provides some guidance. In this case, the Elephant & Castle group of companies operated pubs in the United States and Canada. In June 2011, the group, comprising 14 companies including three Canadian corporations, began proceedings under Chapter 11 of the US Bankruptcy Code in Massachusetts. The group sought to continue operating while it attempted to sell its business as a going concern. Immediately following the Chapter 11 filing, the lead US debtor, Massachusetts Elephant & Castle Group, Inc, acting as foreign representative, sought recognition in the Superior Court of Ontario of the Chapter 11 proceedings as a "foreign main proceeding" under the CCAA. The registered offices of the three Canadian debtor companies were all in Canada, as were nearly half of the group's operating locations and 43% of its employees. Elephant & Castle argued that the Canadian companies operated as part of a highly integrated group that was managed entirely from the United States, so that the US proceedings should be recognized as foreign main proceedings for all debtors, including the Canadian companies. The CCAA presumes, as does the Model Law, that the registered office of the debtor is its COMI. Although that presumption is easily rebutted in the case of a single corporation, there are no clear guidelines as to how to determine the COMI of a group of companies. The analysis to determine COMI has to be performed on an individual basis for each debtor.

The court determined that each case was to be decided on a contextual analysis of the factors that are usually significant in determining COMI:

(1) the location of the debtor's headquarters, head office or "nerve centre";

(2) the location of the debtor's management; and

(3) the location that significant creditors recognize as being the centre of the company's operations.

Depending on the factual matrix, some factors may be more important than others. None of the factors alone would necessarily be determinative. The court noted that while other factors may be relevant in specific cases, "it could very well be that they should be considered to be of secondary importance and only to the extent that they relate to and support the above factors". Ultimately, the court found that the location of the debtors' "headquarters or head office or nerve

[245] *Ibid*.
[246] Wood, *supra* note 20, p 604.
[247] *Re Massachusetts Elephant & Castle Group Inc (2011),* 81 CBR (5th) 102 (Ont SCJ).

centre", as well as the group's management team, was in Boston. The judge also took into consideration that a "substantial" lender did not oppose the application.

The recent *Hollander Sleep Products*[248] case provides an example of what "other factors" can be relevant in rebutting the CCAA presumption that a company's COMI is the location of its head office. In determining that Hollander Canada (with its head office in Vancouver) in fact had its COMI in the United States, the court considered – in addition to the three factors set out above – that (1) its business is "closely integrated" into Hollander's business in the United States, (2) its registered office is in Canada "only for corporate purposes", (3) Hollander Canada is "almost wholly dependent" on Hollander US office for administrative functions, (4) all of Hollander Canada's directors reside in the United States, (5) Hollander Canada's records are maintained at Hollander US head office, and (6) Hollander Canada is "entirely dependent" on Hollander US and its other subsidiaries for "the majority of licensing agreements, design partnerships and company-owned brands".[249]

Nortel Networks Corp, Re[250] is an example of a recent, complex case involving corporate groups in the international context. The *Nortel* proceedings were highly complex and involved Canadian debtors filing under the CCAA, US debtors filing under US Chapter 11 and proceedings commenced by Nortel parties in other parts of the world including the UK. The various proceedings were highly coordinated, particularly between the US and Canadian courts and resulted in the worldwide going concern sale of Nortel's business units to various purchasers and the eventual allocation and distribution of the sales proceeds to Nortel's creditors on a worldwide G16 basis. However, the case illustrates the complexities of group insolvencies and some of the frailties of the Model Law and COMI analysis when dealing with sophisticated, multi-national corporate groups.

Nortel operated under an intricate and complex business model, with various business units interwoven across multiple countries. On January 14, 2009 (prior to the 2009 amendments to the BIA and CCAA coming into force) Nortel initiated coordinated creditor protection proceedings in multiple jurisdictions including Canada, the US and EMEA (Europe, Middle East, Africa). A COMI application was made to appoint Joint Administrators of the EMEA estates. Although steps were taken to coordinate the worldwide proceedings as between Canada, the US and EMEA, the three "main" estate restructurings proceeded on a concurrent basis with no determination being made as between them as to a "main" governing proceeding. An interim funding and settlement agreement (IFSA) was agreed between the estates which allowed cash to be distributed among the group for operational needs during the restructuring. As part of the IFSA the estates also agreed to cooperate in a coordinated sale of the businesses and assets and leave the allocation of the proceeds until later in order to focus efforts on maximizing realizations. The Nortel subsidiaries in Canada and the US created and had the courts approve a cross-border protocol (the Protocol) to streamline proceedings between Canadian and US courts. Among other things the Protocol affirmed that Ontario and Delaware courts would have respective jurisdiction over Canadian and US subsidiaries but that motions could be filed and heard in either court or simultaneously by both courts. Although the courts and the parties

[248] 2019 ONSC 3238.
[249] *Idem*, para 35.
[250] [2015] ONSC 4170.

worked together in coordinating the sales of Nortel's business units, when it came time to allocate the fruits of those labours – the sales proceeds - fundamental disputes broke out as to the proper allocation of the proceeds between the estates and as to what body had jurisdiction to determine the allocation dispute. The EMEA estate favoured arbitration, the US and Canadian estates favoured a determination by the US and Canadian courts. The US and Canadian courts determined that jurisdiction had been ceded to them jointly under the IFSA and conducted ground-breaking, joint concurrent cross-border trials to determine how to allocate the USD 7.3 billion worth of sales proceeds.

The two courts communicated effectively and agreed to cooperate while conducting the concurrent trials. The use of technology allowed for testimony and argument to be relayed between the US and Canada, permitting judicial consideration to be given to the opinions of every party. The judges in both jurisdictions discussed their reasoning prior to rendering a decision and chose to allocate the funds between the various debtors on a *pro rata* basis. A relatively straight-forward and simple decision for a complex set of issues, demonstrating the reciprocal understanding of and respect for foreign proceedings between Canada and the US. While the ending was relatively "happy", the concurrent trials raised concerns about the enforceability and finality of two independent court decisions that might not have concurred in the result. Moreover, the predicate to the concurrent trials was the finding of jurisdiction based on the contractual agreement between the parties. The IFSA allowed the courts to sidestep thorny issues about COMI, jurisdiction and enforceability that might have arisen in its absence.

Self-Assessment Exercise 5

Question 1

Describe the public policy exemption and if you think it is a necessary inclusion in the BIA and the CCAA.

Question 2

Are Canadian courts limited to Canadian entitlements and remedies in the relief they can provide a foreign representative?

Question 3

What factors does the Canadian court consider in determining COMI when faced with a recognition application for a corporate group with multiple domestic and foreign debtors?

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

8.1 General

Canada has taken a broad and liberal approach to the enforcement of foreign judgments, but it can nonetheless be time consuming, costly and procedurally complex to have a foreign judgment recognized and enforced.

There are two main routes to enforce a non-Canadian judgment in Canada. The first is by way of reciprocal enforcement legislation when the judgment in question is issued by a jurisdiction governed by reciprocal enforcement legislation. In the common law provinces, the second is to obtain common law recognition of the judgment in accordance with the test articulated in the Supreme Court of Canada's decision in *Morguard Investments Ltd v De Savoye*.[251] Québec is governed by the Civil Code, a comprehensive piece of legislation, and not by the common law. As such, the requirements developed by the common law courts do not apply. Instead, the substantive requirements for the recognition and enforceability of non-Québec judgments are found in the code itself.

8.2 Reciprocal enforcement of judgments

Most Canadian provinces have created a streamlined process for enforcing judgments from particular jurisdictions by way of "reciprocal enforcement of judgments" legislation, which allow a litigant to "register" a judgment by way of a simplified court application and thereafter enforce. However, reciprocal enforcement of judgments legislation is only available to parties from reciprocating jurisdictions.

For instance, Canadian provinces – except Québec – are all reciprocating jurisdictions of one another. It may be counter-intuitive that judgements of provinces would require recognition between each other, but it must be remembered that provinces have broad legislative authority over significant areas, resulting in different laws about similar subject matter.

In addition, a number of provinces have enacted legislation to simplify the procedure for registering and enforcing foreign judgments from particular countries and / or particular US states, although the scope and availability of this legislation varies significantly between provinces.[252]

Canada is also a party to several international conventions, such as the *Convention Between Canada and the United Kingdom of Great Britain and Northern Ireland Providing for the Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters*.[253] This convention has been incorporated into Canadian law by way of both federal and provincial

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[251] [1990] 3 SCR 1077.

[252] For example, British Columbia has reciprocal agreements with Washington, Alaska, California, Oregon, Colorado and Idaho, among others: *Court Order Enforcement Act,* RSBC 1996, c 78; Alberta has reciprocal agreements with Washington, Idaho and Montana: *Reciprocal Enforcement of Judgments Act,* RSA 2000, c R-6.

[253] *Canada-United Kingdom Civil and Commercial Judgments Convention Act*, RSC 1985, c C-30.

legislation, such as Ontario's Reciprocal Enforcement of Judgments (UK) Act,[254] which together allow the Canadian federal and provincial governments, as well as the government of Great Britain and Northern Ireland, to mutually register and enforce judgments obtained in each-others' jurisdictions with the same force and effect, provided it is within six years of the judgment.[255]

In Canada, the enforcement of non-Canadian arbitral awards is governed by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) and the UNCITRAL Model Law on International Commercial Arbitration. Both the federal and each of the common law provinces have ratified the convention.[256]

8.3 The common law approach

Where there is no reciprocating legislation or convention, enforcement at common law requires the enforcing party to start an enforcement proceeding in the relevant Canadian court and meet the test for enforcement. The Canadian common law has embraced a broad and liberal test for the enforcement of foreign judgements. In *Morguard Investments Ltd v De Savoye*[257] the Supreme Court of Canada adopted the approach that a foreign judgement may be presumptively enforced in Canada, provided there is a "real and substantial connection" between the foreign court and: (i) the defendant, (ii) the cause of action, or (iii) the subject matter of the action.

The underlying rationale of *Morguard* is one of comity. The Supreme Court noted that in an era where the business community operates globally, there must be a mechanism to accommodate the expansion in the realm of foreign judgements. Since the *Morguard* test has developed, the court has recognized a number of different scenarios where a "real and substantial connection" exists with the foreign jurisdiction. For example, if the Canadian defendant was carrying on business in the foreign jurisdiction, had a physical presence, business premises, employees or commercial relationships in the foreign jurisdiction.[258]

8.4 Requirements for recognition

For a foreign judgement to be recognized under the "real and substantial connection" test, it must meet the following criteria: (i) the judgement must have originated from a court that had jurisdiction under the principles of private international law as applied by Canadian courts, (ii) the judgement must be final and conclusive in the original jurisdiction, and (iii) the judgement must be for a definite and ascertainable sum of money, or if not a money judgement, its terms must be sufficiently clear, limited in scope and the principles of comity the require the domestic court to enforce it.[259]

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[254] RSO 1990, c R.6.

[255] Similar legislation has been enacted in all Canadian provinces, with the exception of Québec.

[256] See *United Nations Foreign Arbitral Awards Convention Act*, RSC, 1985, c 16 (2nd Supp).

[257] *Morguard Investments Ltd v De Savoye* [1990] 3 SCR 1077, *supra* note 232.

[258] M Koehnan and A Klein, "The Recognition and Enforcement of Foreign Judgements in Canada", IBA Annual Conference 2010, Vancouver, p 6 (hereinafter referred to as Koehnan and Klein). See, for example, *Van Breda v Village Resorts Ltd* [2012], SCC 17 and *Chevron Corp v Yaiguaje* [2015], SCC 42.

[259] Koehnan and Klein, *supra* note 258, p 1.

Canadian law accepts certain limited defences to the recognition of foreign civil judgements. Namely fraud, lack of natural justice and public policy. These defences are narrow in scope and do not allow for the wholesale re-litigation of the underlying merits of a foreign judgement where the jurisdiction of the foreign court is properly founded. [260] In practice theses defences are rarely made out in the civil, commercial case context. Canadian courts will also not enforce foreign judgements that are "penal" in nature, foreign judgments based on taxation or "revenue laws", and orders arising out of matters of public law.

8.5 Public policy

The defence of public policy prevents the enforcement of a foreign judgment that is contrary to fundamental Canadian concepts of justice. What offends "fundamental concepts of Canadian justice" is, to paraphrase the famous quote by US Supreme Court judge Potter Stewart, a matter that Canadian courts "know when they see it".[261] By way of concrete example, however, this defence would guard against the enforcement, in Canada, of a judgment rendered by a foreign court shown to be corrupt or biased. It is the foreign law itself or the way it is institutionally implemented that must be contrary to the Canadian concept of justice in order for the defence of public policy to apply, not merely the fact that the law is different, that the underlying facts are sympathetic to the defence, or that the enforcing Canadian court might have reached a different result.[262] This defence has a narrow application, and is not employed often or lightly by Canadian courts since it requires condemnation of the foreign law or court process underlying the judgment, which can have implications for the enforceability of Canadian judgements abroad.[263]

8.6 Defence of fraud

A foreign judgment will not be recognized and enforced if it is obtained by fraud.[264] There are two types of fraud relevant to this defence: (1) fraud going to the merits of the foreign judgment and (2) fraud going to jurisdiction. Unlike fraud going to jurisdiction, fraud relating to the merits of the foreign judgment can be raised "only where the allegations [of fraud] are new and not the subject of prior adjudication".[265] Where material facts not previously discoverable arise to potentially challenge the evidence in the foreign court, the court may decline recognition of the foreign judgment.[266] For the defence of fraud on the merits to apply, the defendant in the foreign action must demonstrate that the facts sought to be raised could not have been

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[260] *Beals v Saldanha*, [2003] 3 S.C.R. 416, 2003 SCC 72.

[261] *Jacobellis v Ohio*, 378 US 184 (1964) is a United States Supreme Court decision involving whether the state of Ohio could ban the showing of the Louis Malle film *The Lovers* (*Les Amants*), which the state had deemed obscene, under the First Amendment. Holding that the US Constitution protected all obscenity except "hard-core pornography", Justice Potter Stewart wrote, "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that."

[262] *Beals* decision*, supra* note 260, at para 71.

[263] *Idem*, para 75.

[264] *Idem*, para 43.

[265] *Idem*, para 51.

[266] *Ibid.*

discovered by the exercise of due diligence prior to the obtaining of the foreign judgment.[267] In contrast to fraud on the merits, fraud going to jurisdiction can always be raised as a defence before a domestic court to challenge a foreign judgment.[268]

8.7 Lack of natural justice

The denial of natural justice in that there was a denial of fair process can also be the basis of a challenge to a foreign judgment. Fair process is one that, in the system from which the judgment originates, reasonably guarantees basic procedural safeguards such as judicial independence and fair ethical rules governing the participants in the judicial system. The defence of natural justice is restricted to the form or procedure of the foreign procedure (due process) and does not relate to the merits of the case. In Canada, natural justice has frequently been viewed to include, but is not limited to, the necessity that a defendant be given adequate notice of the claim made against him or her and that be granted an opportunity to defend.[269]

9. INSOLVENCY LAW REFORM

There are currently no formal reform proposals concerning insolvency law in Canada. Industry Canada produced a report in 2015 reviewing Canada's insolvency laws. Industry Canada received submissions on a number of issues that could be addressed to improve the functionality of Canada's insolvency regime. For the purposes of this course, there were a few insolvency issues that interested stakeholders considered problematic under the BIA and the CCAA.

The streamlining of proceedings was identified as a concern by Canadians. Insolvency proceedings, as identified above, can be extremely complex. Corporate restructurings are particularly difficult and many actions require court approval for interim actions. Suggestions included putting a system in place that allowed for a more efficient process that permitted a quick resolution, while ensuring fairness through necessary checks and balances. Additionally, stakeholders suggested that the cost of restructuring under the existing mechanisms is often too high and that a more streamlined proceeding would allow small and medium sized businesses to take advantage of the procedures available under the BIA or the CCAA.

Cross-border insolvency issues were also identified as areas of concern by interested stakeholders, suggesting that reform may be necessary to ensure Canada's insolvency laws keep pace with global trends. Canada is an active participant in the work being undertaken by UNCITRAL's Working Group V, but stakeholders noted that Canada should be cautious to undertake any reforms that do not promote investment in Canada and protect the legitimate interests of Canadian firms in global markets.

Modernization was noted as a possible issue by Canadians. Currently, the legislative structure of insolvency regimes is dictated by several different statutes, as outlined above. Stakeholders suggest a more streamlined approach under statutory insolvency law may provide more clarity

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[267] *Idem*, para 52.
[268] *Idem*, para 51.
[269] *Idem,* paras 59-70.

and simplicity when dealing with bankrupt and insolvent persons. This may include an overhaul of the BIA to remove outdated concepts and provisions, since the last time the BIA was comprehensively reformed was in 1949. Instead of an overhaul of the BIA, another option would be to increase the roles and responsibilities of the Superintendent of Bankruptcy to allow for a more flexible approach.

On April 8, 2019, the federal government introduced Bill C 97, An Act to Implement Certain Provisions of the Budget Tabled in Parliament On March 19, 2019 and Other Measures, which includes proposed amendments to the BIA, as well as the CCAA. Bill C 97 received Royal Assent on June 21, 2019, and entered into force on November 1, 2019.

The amendments are ostensibly directed at making insolvency proceedings more fair, transparent and accessible for workers and pensioners and include the following:

(a) Under the BIA, to:

- require all parties in a proceeding under the BIA to act in good faith;
- allow the courts to inquire into certain payments made to, among other persons, directors or officers of a corporation in the year preceding insolvency; and
- impose liability on directors of corporations in respect of such reviewable payments.

(b) Under the CCAA, to:

- limit the relief provided in initial orders made pursuant to section 11 of the CCAA to what is “reasonably necessary” for the continued operations of the company;
- require all parties in the proceedings to act in good faith;
- allow the courts to issue orders compelling certain persons to disclose any aspect of their economic interest in respect of the debtor company; and
- limit the time period of the initial stay of proceedings to a period of 10 days (instead of 30 days).

The changes to the BIA and CCAA to require that all participants in insolvency proceedings “act in good faith” also give the court broad discretion to craft a remedy where this obligation is breached: as of 1 November 2019, subsections 4.2(1) and 18.6(1) of the BIA and CCAA (respectively) impose a statutory duty of good faith for “interested persons” in “any proceedings” under each Act. Subsections 4.2(2) and 18.6(2) of the BIA and CCAA (respectively) give the court, on application from any other “interested person”, the broad power to “make any order that it considers appropriate in the circumstances” where it finds that an interested person has failed to act in good faith. “Good faith” is not defined in either statute, and there do not appear to be any other (statutory) limiting conditions on this order-making power.

Note that debtors and insolvency trustees **already** have obligations to act in good faith in insolvency proceedings.[270] Leading Canadian insolvency scholars took this to indicate that this new statutory duty of good faith is mainly meant to apply to **creditors**.[271] Canadian insolvency jurisprudence has previously recognized that creditors must act in good faith when voting on restructuring proposals / plans.[272] However, recent Canadian insolvency jurisprudence has provided some guidance related to how creditors and debtors can comply with the new statutory duty of good faith.

The Ontario Court of Appeal's recent decision in *Laurentian University of Sudbury*, *Re*, provides guidance on a debtor's duty of good faith pursuant to subsection 18.6(1) of the CCAA. In this case, the Ontario Court of Appeal held that a debtor serving a notice of disclaimer with the knowledge that serious financial implications for their contractual counterpart could follow, did not constitute bad faith conduct.[273] The choice in this case was either (i) to allow the disclaimer, recognizing that cessation of operations of the debtor's contractual counterpart was a potential result, or (ii) disallow the disclaimer, acknowledging the hardship it could cause to the debtor and the other contractual party.[274] The Ontario Court of Appeal agreed with the lower court's reasoning that both outcomes were undesirable, but that the "least undesirable choice" was to uphold the notice of disclaimer because it would enhance the prospects of a viable plan of compromise or arrangement and the alternative would likely lead to both parties being forced to suspend or cease operations.[275] As such, the Court of Appeal affirmed the principle that a debtor prioritizing their interests in developing their restructuring plans does not run contrary to the statutory duty of good faith pursuant to subsection 18.6(1) of the CCAA.

Additionally, in 2010, the Supreme Court of Canada held in *Century Services*[276] that the "requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising CCAA authority".[277] The Court clarifies that the "appropriateness" of an order turns on whether it advances the remedial policy objectives of the CCAA.[278]

However, *Century Services* long predates the statutory duty of good faith: the Court in that case had in mind the court's general order-making power under section 11 of the CCAA (that is, that the supervising court may make "any order it considers appropriate in the circumstances").

Further judicial guidance on the new duty comes from the Supreme Court in the recent *Bluberi* case.[279] In that case, the SCC held that a "supervising judge has the discretion to bar a creditor from voting on a plan of arrangement where they determine that a creditor is acting for an

[270] See, eg, BIA, ss 50(12)(a) and 50.4(9)(a).
[271] Lloyd Houlden, Geoffrey B Morawetz and Janis Sarra, *Bankruptcy and Insolvency Law of Canada,* 4th ed (Thomson Reuters, 2019), at HMANAY B§51 (Houlden & Morawetz Bankruptcy and Insolvency Analysis).
[272] See *Re Laserworks Computer Services Inc,* 1998 NSCA 42 and *Re Blackburn Developments Ltd,* 2011 BCSC 1671.
[273] *Laurentian University of Sudbury, Re*, 2021 ONCA 448 at para 44.
[274] *Idem*, para 43.
[275] *Ibid*.
[276] *Re Ted Leroy Trucking [Century Services] Ltd,* 2010 SCC 60 (*Century Services*).
[277] *Idem*, para 70.
[278] *Ibid*.
[279] 9354-9186 *Quebec Inc v Callidus Capital Corp*, 2020 SCC 10 (*Bluberi*).

improper purpose".[280] However, the Court bases its decision on the *Century Services* framework (in the context of the section 11 power), and **does not purport to act under the new duty provisions**. Despite this, the Court refers to the new statutory duty of good faith as simply an "express[ion]" of "the well-established requirement that parties must act in good faith in insolvency proceedings"[281] – apparently referring to the *Century Services* framework.

As Canadian courts have pointed out before,[282] the Supreme Court in *Bluberi* did not seem to take issue – at least in principle – with the notion that creditors are entitled to vote on plans/proposals in their own self-interest.[283] However, it disputed the Court of Appeal's determination that the conduct before it was innocently self-interested rather than improper. This conduct consisted of the secured creditor's (Callidus) attempt to override the (disapproving) vote on its first-proposed plan, which purported to release a litigation claim by the company against Callidus (and others) for a significant amount (in the range of CAD 200 million), by proposing a near-identical second plan and vote on the plan itself while "strategically" valuing the security attached to its CAD 3m claim at nil. This was "strategic" in that it (sought to) allow Callidus to "stand in the position of an unsecured creditor" and – given the size of its (now purportedly "unsecured") claim – certainly succeed on the second vote.[284]

Since, the Court held, Callidus did this for the "sole purpose of obtaining releases" from the claims held by the debtor company against it (which were the sole assets securing Callidus' claim),[285] the Court overturned the Court of Appeal's decision and declined to disturb the Supervising Judge's decision to bar Callidus from voting on its "second kick at the can" plan.[286]

The Court in *CWB Maxium Financial* provides additional guidance on the statutory duty of good faith under the BIA.[287] In this case, the Court held that when a creditor is invoking insolvency proceedings, it is appropriate for a Court to import the common law principles stated and developed in the *Bhasin* and *Callow* cases to "give content" to the notion of "good faith" found under section subsection 4.2(1) of the BIA.[288] For example, the Court noted that when a contract includes a right on the lender's part to appoint a receiver or to seek such appointment, the duty of good faith requires the parties not to lie to or mislead one another with respect to the status of the loan or the state of the lender-borrower relationship.[289] As such, Canadian courts have imported the principles under the organizing principle of good faith in contractual performance to inform their interpretation of the new statutory good faith requirement under the BIA and CCAA.

In conclusion, Canadian courts have provided some judicial guidance for creditors and debtors on the duty of good faith in insolvency proceedings, but the law in this area is still nascent.

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[280] *Idem*, para 2.
[281] *Idem*, para 50.
[282] See Blackburn, supra note 272.
[283] *Idem*, para 81.
[284] *Idem*, para 78-80.
[285] *Idem*, para 80.
[286] *Idem*, para 78.
[287] *CWB Maxium Financial Inc v 2026998 Alberta Ltd*, 2021 ABQB 137.
[288] *Idem*, para 59.
[289] *Ibid*.

Participants in insolvency proceedings may have greater clarity as to when a court might make an adverse order under the new good faith provisions, but there is still ambiguity as the delineation point between rational economic self-interest and breach of the duty of good faith.

10. USEFUL INFORMATION

The following websites may provide helpful information for further research and insight into the insolvency environment in Canada:

10.1 Legislation

- Bankruptcy and Insolvency Act: https://laws-lois.justice.gc.ca/eng/acts/B-3/;
- Companies' Creditors Arrangement Act: https://laws-lois.justice.gc.ca/eng/acts/c-36/;
- Winding up and Restructuring Act: https://laws-lois.justice.gc.ca/eng/acts/W-11/.

10.2 Resources

- Office of the Superintendent of Bankruptcy Canada: http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/home;
- International Insolvency Institute – Resource Library (Canada): https://www.iiiglobal.org/international-resource-library?region=ca&name=Canada.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

What remedies are available to an unsecured creditor to enforce their rights outside of a formal insolvency process?

Question 2

What formal restructuring remedies are available for corporations under Canadian law and why might a debtor company choose one over another?

Question 3

How might a provincial law that conflicted with a federal law that affected rights and obligations in an insolvency scenario be treated under Canadian constitutional principles?

Commentary and Feedback on Self-Assessment Exercise 1

Question 1

Unsecured creditors have a variety of remedies to enforce their rights outside of the formal insolvency process.

Civil Action: Unsecured creditors can bring a civil action to obtain a judgement against the debtor and then collect on the judgement to satisfy their claim.
Injunctive Relief: An unsecured creditor also has the option of obtaining an injunctive order in a situation where there is concern that the assets may be depleted or disposed of.
Property Lien: Under certain statutes (for example the *Builders Lien Act*) there are provisions that allow a particular type of unsecured creditor to put a lien on the property of the debtor for particular types of claims. Once the debtor's property is sold the creditor receives the proceeds from the sale in the amount of the lien.
Fraudulent Conveyances and Preferences: Unsecured creditors have rights through the provincial Fraudulent Conveyances Act and Assignments and Preferences Acts by which transfers of assets by a debtor with the intent of avoiding payment to a creditor may be deemed void.
Oppression Remedy: If an unsecured creditor believes the corporation is acting or has acted in a way that unfairly undermines or prejudices their legitimate expectations, they may assert their claim in court pursuant to the "oppression remedy" available under either the CBCA or the provincial corporations acts. If the unsecured creditor proves their claim, the court has broad remedial powers and can apply the appropriate remedy.

Question 2

A debtor company has the option of restructuring under the BIA, the CCAA or the CBCA. Depending on a variety of factors, including the debtor company's financial situation, the complexity of its affairs, the nature of its restructuring needs, and costs they may choose to restructure under one statute as opposed to another. For example, restructuring under the BIA is a more formal procedure with statutory steps and strict rules regarding timelines whereas the CCAA is more discretionary and largely driven by the court. If a debtor company (or companies) is in a situation where they require a more flexible approach, they would likely choose to restructure under the CCAA. While more flexible, the CCAA also has a $5 million debt threshold for debtor companies and tends to be more costs intensive as a result of it being a largely court driven process. As will be discussed in more detail later in the module, strategic considerations may also come into play. There is an automatic stay of proceedings on the filing of a Notice of Intention to commence proposal proceedings under the BIA. In CCAA proceedings a stay is not automatic but is granted by the court as part of the initial order on the application to place the company into CCAA protection. In certain instances a BIA proposal filing may be made to obtain an immediate and automatic stay and the proceedings converted to CCAA proceedings later by court order. Where a debt restructuring or recapitalization is contemplated as opposed to an operational restructuring, the use of the CBCA arrangement provisions is an increasingly popular means of facilitating the restructuring of federally registered companies as it can be more cost efficient compared to a *CCAA* restructuring, has fewer court attendances and avoids the stigma of taking steps under an insolvency specific statute.

Question 3

When a provincial law conflicts with a federal law such that it frustrates the purpose of a valid federal law or creates an operational conflict such that it is impossible to comply with both laws, the doctrine of paramountcy provides that valid provincial law will be rendered inoperative where there is either an operational conflict with federal law, such that complying with the provincial law would result in non-compliance with the federal law, or the operation of the provincial law frustrates the purpose of the federal law. If the provincial law does not frustrate the purpose of the federal law or create an operational conflict it remains operative and may inform rights and obligations during insolvency proceedings.

Self-Assessment Exercise 2

Question 1

Are a secured creditor's rights regulated by the liquidating bankruptcy process, and if so, how?

Question 2

Provide an example of a situation where a secured creditor would choose to enforce their rights as a creditor within the bankruptcy process.

Question 3

What are the consequences of failing to attach or perfect a security interest?

Commentary and Feedback on Self-Assessment Exercise 2

Question 1

Secured creditors' rights are not affected by a liquidating bankruptcy and secured creditors may enforce their security outside of the bankruptcy process. This results in secured assets not being included in the pool of assets subject to bankruptcy proceedings. The trustee in bankruptcy is entitled to any surplus exceeding the secured creditor's interest to distribute among the remaining creditors. A bankruptcy may therefore affect the rights of secured creditor to the extent necessary to allow the trustee to realize on any surplus value in the collateral.

Question 2

A secured creditor may elect to participate in the bankruptcy process as an unsecured creditor in the event that their claim is not fully satisfied upon realizing on the secured assets.

As will be discussed later in the module, secured creditors may also seek to initiate a "strategic bankruptcy" at the end of a receivership or "going concern" liquidating restructuring concurrent with distributions to reverse certain federal and provincial government priorities that would rank ahead of them outside a bankruptcy process.

Question 3

For attachment to occur, value must be given by the secured party, the debtor must have rights in the collateral, and the debtor must sign a security agreement that describes the collateral sufficiently to enable it to be identified, or the secured party must have possession or control of the collateral. Perfection is achieved through registration, by filing a PPSA "financing statement", or by possession or control of the collateral. "Control" occurs when the collateral can be sold by a secured party without any further action of the debtor.

If a creditor fails to attach or perfect a security interest their interest will be considered unperfected in an insolvency process and the creditor will rank as an unsecured creditor. Both attachment and perfection must occur in order for the secured creditor to have a valid and enforceable security interest.

Self-Assessment Exercise 3

Question 1

Assume the only assets of a BV registered company consist of sales proceeds of less than CAD 500,000 held by lawyers in Canada arising from the sale of a property located in Canada. Setting aside any issues under BV corporate or insolvency law, can the company file for voluntary bankruptcy in Canada? If so, can a foreign creditor with a litigation claim that has not resulted in a final judgement seek to prove that claim and participate in the Canadian proceedings?

Question 2

How are executory contracts treated in a liquidating corporate bankruptcy?

Question 3

A debtor grants security to an arm's length creditor for past indebtedness two months before the debtor file for voluntary assignment into bankruptcy. Can the grant of security be challenged by the trustee? What if the grant of security is made for both past indebtedness and future obligations in favour of a critical supplier?

Question 4

If there aren't sufficient assets in the estate to pursue an impeachable transaction, is there any mechanism for creditors to pursue the action themselves?

Commentary and Feedback on Self-Assessment Exercise 3

Question 1

The BV registered company would be able to file for voluntary bankruptcy in Canada. The definition of "debtor" in section 2 of the BIA includes an insolvent person who, at the time an act of bankruptcy was committed by the company, resided or carried on business in Canada. Since a "person" includes a company and an "insolvent person" extends to companies with property in Canada, the BV registered company would meet the definition of debtor in section 2 of the BIA. This means the BIA is broad enough to support a filing by a foreign registered company with assets or property in Canada.

In turn, a foreign creditor with a litigation claim may also participate equally in the bankruptcy because where is no distinction made between foreign creditors and creditors under the BIA. Even though the litigation claim has not resulted in a final judgement, under section 121 of the BIA all debts and liabilities to which the bankrupt may become subject to (for example, a contingent, unliquidated future judgement in litigation) are provable under the BIA and must be valued by the trustee.

Question 2

A bankruptcy does not terminate executory contracts in and of itself. Provided post-filing obligations are kept current, the contract continues, and counter-parties are stayed from terminating contracts for pre-filing breaches. Executory contracts in a bankruptcy are controlled by the trustee. The trustee may exercise his or her discretion to repudiate, assign or perform all or part of the contract for the benefit of the creditors. The ability to perform all or part of a contract while liquidating a corporate bankruptcy can be an important value add for creditors. For example, if a corporation has a production process it may be beneficial to the corporation to complete the contract if it will result in a significant payment and thus an increased pool of assets for stakeholders.

Question 3

The trustee has the ability to challenge the grant of security. In order to establish a preferential payment in an arm's length transaction, the trustee must first establish that the payment happened within three months of the event of bankruptcy. In this scenario, the event of bankruptcy occurred when the debtor filed for a voluntary assignment into bankruptcy so the grant of security is within the lookback period. The trustee must then prove: (i) that the debtor was insolvent at the time of the transfer, and (ii) that the transfer had the actual effect of giving the creditor a preference over the debtor's other creditors.

If the trustee can establish these three elements, a rebuttable presumption arises of an intention to prefer and the onus shifts to the creditor to prove that the debtor did not intend to give the preference.

If the grant of security is made for both past indebtedness and future obligations in favour of a critical supplier that transaction may be considered a necessary transaction in order for the debtor corporation to stay in business. If the trustee is challenging the transaction, the court may consider that enough evidence to rebut the presumption.

Question 4

Creditors can use section 38 of the BIA to pursue the action themselves. Creditors may apply to the court to pursue the trustee's remedies for the benefit of those creditors that fund the proceedings, with any surplus distributed to the other creditors on a *pro-rata* basis.

Self-Assessment Exercise 4

Question 1

Describe debtor-in-possession (DIP) financing and why it is necessary when a company is restructuring.

Question 2

What are the advantages of using the CBCA to restructure the debts of a federal company? Is this an appropriate mechanism to use where an operational restructuring is necessary?

Question 3

Could a debtor company sell part of its assets in CCAA or BIA proposal proceedings on a liquidation basis to fund the proceedings while it considered further going concern or liquidation assets sales? If so, what factors would the court look at when considering whether to approve such sales?

Commentary and Feedback on Self-Assessment Exercise 4

Question 1

When a company is restructuring, it will typically require capital to continue operations. However, if they are in a corporate rescue process the company is generally already over-financed in the sense that they have granted security over all of their assets and have used all the financial resources available to them. Therefore, an incentive must be created for a creditor to lend to a debtor company in a restructuring process, or it would be unlikely that the new lender would receive a return of principal and interest on funds advanced. DIP financing allows new lenders to provide capital to a corporation, and in turn the new lender is given super-priority and will jump ahead of the other lenders to whom the debtor has previous obligations. This way, if the restructuring is unsuccessful the new lender is protected, but if the restructuring is successful the previous creditors receive the benefit of potentially a higher return than if the corporation is forced into a liquidating bankruptcy. Without DIP financing, a restructuring is often not possible and a liquidating bankruptcy is inevitable.

Question 2

The advantages to using section 192 of the CBCA to restructure is it allows a company to restructure outside of the insolvency process. It provides an immediate benefit to companies through a restructuring of assets and liabilities. It is also largely considered more cost efficient than restructuring under either the BIA or the CCAA. Furthermore, the CBCA has been broadly interpreted by the courts which allows for a more flexible procedure for companies.

Section 192 of the CBCA cannot be used for operational restructuring, if a company requires operational restructuring they must either submit a proposal under the BIA or a plan of arrangement under the CCAA.

Question 3

A debtor company has the ability to sell part of its assets in CCAA or BIA proposal proceedings on a liquidation basis to fund the proceedings. Judges prefer to see the sale of the business as a going concern, but will also approve the sale of assets in a piecemeal fashion if it will result in the best outcome for stakeholders.

A sale of assets out of the ordinary course of business is regulated through section 65.13 of the BIA and section 36 of the CCAA. Under the BIA and the CCAA, the courts have the ability to approve the sale of some or all of the debtor company's assets free and clear of all encumbrances.

When deciding whether or not to approve the sale, the court is required to consider, among other things:

- whether the process leading to the proposed sale was reasonable in circumstances;
- whether the CCAA monitor or BIA proposal trustee approved the process;
- the level of consultation with creditors;
- the effect of the proposed sale on creditors and other interested parties; and
- whether the consideration to be received is fair and reasonable, taking into account market value.

Additionally, if the sale is to a related person, there is an even higher threshold and the debtor company must demonstrate that they made good faith efforts to sell these assets to non-related parties.

Self-Assessment Exercise 5

Question 1

Describe the public policy exemption and if you think it is a necessary inclusion in the BIA and the CCAA.

Question 2

Are Canadian courts limited to Canadian entitlements and remedies in the relief they can provide a foreign representative?

Question 3

What factors does the Canadian court consider in determining COMI when faced with a recognition application for a corporate group with multiple domestic and foreign debtors?

Commentary and Feedback on Self-Assessment Exercise 5

Question 1

The public policy exemption in the BIA and the CCAA permit the court to "refuse to do something that would be contrary to public policy". The exemption thus allows courts to refuse to act even if the particular foreign proceedings meet the recognition requirements under either the BIA or the CCAA. "Public policy" is not defined in either act and is a matter of interpretation by the court.

There are arguably both advantages and disadvantages to the public policy exemption. On the one hand, the exemption provides flexibility to the courts in situations where approving a foreign proceeding may result in a significant disadvantage to Canadian creditors. However, it also provides courts with the ability to usurp the statutory regime place by Parliament and to subvert the consistency of application and overall comity that the UNCITRAL Model Law seeks to foster.

This kind of residual discretion can be quite alien to those with a civil law background. The Model Law is structured on the basis of comity and providing consistency of outcome. If Canadian courts chose to exercise the public policy exemption frequently and inconsistently, it would subvert the entire rationale that underlies the Model Law. In practice, the public policy exemption has traditionally been interpreted in a restrictive manner and is rarely exercised by the courts, and only where there appears to be asymmetrical or unfair treatment of Canadian creditors *specifically*. In the author's view it is a "failsafe" that is not atypical of the kind of residual discretion common law courts traditionally reserve to themselves to avoid mechanical application of the law in situations of manifest injustice.

Question 2

Canadian courts are not restricted in the relief they can provide to foreign representatives. Both the BIA and the CCAA contain broadly worded, discretionary powers that provide where an order recognizing a foreign proceeding has been made, the court may, on application by the foreign representative, make "any order that it considers appropriate". This includes, but is not limited to, orders respecting the examination of witnesses and the taking of evidence, and the provision of information on the debtor's property and affairs.

The court is not restricted in exercising this discretion to only providing the same or similar remedies as available under Canadian insolvency law. In the past, the court has ordered relief in foreign-main proceedings that would not ordinarily be available in a Canadian proceeding.

Question 3

There is no statutory definition of COMI in either the BIA or the CCAA. In the case of a company, the COMI, in absence of proof to the contrary, is the company's registered office. However, determining the COMI in a corporate group liquidation becomes more difficult if there are parent and subsidiary companies involved across territorial borders.

The court has determined that each case where corporate groups are involved must be decided on a contextual analysis while considering the following factors:

- the location of the debtor's headquarters, head office or "nerve centre";
- the location of the debtor's management; and
- the location that significant creditors recognize as being the centre of the company's operations.
- Depending on the facts of the situation, some factors may be more determinative than others.

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