

## RESTRUCTURING OF INSOLVENT CORPORATIONS IN CANADA

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### Introduction

This paper gives a very general outline of the formal restructuring of insolvent corporations in Canada. For a South African audience, it is important to understand that in Canada a distinction is made between an "insolvent person" and a "bankrupt". A "bankrupt" means a person who has made an assignment into bankruptcy (voluntarily), or against whom a bankruptcy order has been made. An "insolvent person" means a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors amount to \$1 000, and who is for any reason unable to meet his obligations as they generally become due, or who has ceased to pay his current obligations in the ordinary course of business as they generally become due, or the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process would not be sufficient to enable payment of all his obligations, due and accruing due. An "insolvent person" in Canada may avoid bankruptcy by resorting to restructuring processes created by statute. The fact that a person becomes insolvent does not necessarily spell bankruptcy. Canadians are fortunate to have access to bankruptcy courts and insolvency practitioners with a high level of commercial and legal skills to assist them in restructuring their financial affairs and avoiding bankruptcy.

After practising as an advocate in Johannesburg for about fifteen years, I emigrated to Canada. At the Johannesburg bar, I had a busy insolvency and commercial litigation practise. After I re-qualified in Canada to practise there as a barrister and solicitor, I continued to practise in the areas of insolvency and commercial litigation. One of the highlights of practising insolvency in Canada for me is the sophisticated

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restructuring legislation in that country that assists insolvent persons to avoid bankruptcy. When I left South Africa in 1998, I often regretted the needless bankruptcies of significant corporations that could have been rescued had there been a proper legislative framework for restructuring insolvent debtors.

In this paper, I will give an overview of the formal restructuring of insolvent corporations in Canada. I have been away from South Africa for too long to make any responsible comments on the present legislation in South Africa applicable to insolvent corporations, and will therefore not embark on a comparative study.

### **The emergence of Canadian restructuring law<sup>1</sup>**

Both the *Insolvent Act* of 1869 and the *Insolvent Act* of 1875, in common with English bankruptcy legislation of the Victoria era, permitted a debtor to enter into a deed of composition with creditors. The deed would become binding on all creditors if it was approved by the majority of creditors holding three-quarters of the value of debts.

After the repeal of federal insolvency legislation in 1880 due to fraud and abuse by debtors, the provincial law governed any arrangements between debtors and creditors until the enactments of the *Bankruptcy Act* of 1919. The statutory scheme reintroduced by the *Bankruptcy Act* of 1919 permitted an insolvent debtor to make a proposal for a composition, extension, or scheme of arrangement. However, concerns over fraudulent proposals led to amendments to Canadian bankruptcy legislation in 1923 that allowed a debtor to make a proposal only if the debtor first went into bankruptcy. Although the scheme allowed creditors to gain a more accurate picture of the financial affairs of the debtor and curtailed opportunities for abuse by fraudulent trustees, the stigma of bankruptcy diminished debtors' ability to carry on business. This restriction was eliminated in 1949 and the debtors were again able to make proposals without having to go into bankruptcy. The fact that secured creditors were left unaffected was another critical weakness of the proposal

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1 Wood *Bankruptcy* 309.

provisions. The inability to stay the rights of secured creditors severely hampered the effectiveness of these provisions in a commercial context.

The Parliament of Canada enacted the *Companies' Creditors Arrangement Act*<sup>2</sup> (CCAA) in 1933 to provide a mechanism through which a company could attempt to negotiate an arrangement with its creditors. This was during the Great Depression when there was a significant need to protect corporations against aggressive creditors. The CCAA further permitted a court to stay enforcement proceedings of secured creditors. Amendments to the CCAA in 1953 restricted its application to companies that had issued bonds or debentures under a trust indenture. This restriction seriously limited the availability of the statute. The CCAA was revived in the early 1980s, during an economic recession, where the courts conscious of the unavailability of an effective regime for corporate restructuring, recognised "instant trust deeds" for the sole purpose of qualifying corporations to restructure under the CCAA. The CCAA then rapidly became the primary vehicle through which corporate restructuring was affected.

The proposal provisions of the *Bankruptcy and Insolvency Act*<sup>3</sup> (BIA) were amended in 1992 to permit an insolvent debtor to make a proposal to both secured and unsecured creditors with the threshold for acceptance only of a majority of creditors holding two-thirds the value of the claims. Although it was anticipated that the proposal provisions of the BIA would become the primary means for restructuring financially distressed enterprises, the CCAA continued to be employed to restructure corporations and primarily large enterprises. This has given rise to the existence of dual commercial restructuring regimes, a highly distinctive feature of Canadian insolvency law. Therefore, an insolvent debtor will usually need to make an assessment of advantages and disadvantages of restructuring under each regime in order to maximise the chances of success.

The reform of commercial insolvency law has adopted a deliberate strategy of convergence to align the principles under each restructuring regime. Despite this attempt, there are still many significant differences between the two, and it remains

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2 RSC 1985, c C-36.

3 RSC 1985, c B-3.

necessary for legal advisors to conduct a careful evaluation before making a decision to restructure under each regime.

The 2005/2007 insolvency reforms proceeded on the basis that the two general commercial restructuring regimes should be kept separate. This was based on the view that CCAA is more flexible and better suited to resolving the multitude of issues that arise in connection with restructuring of larger businesses. The rule-based approach of the BIA was viewed as being more suitable for small and medium-sized enterprises, where fewer court applications reduced the cost of restructuring. These reforms continued to adhere to the policy of convergence under which differences between the two regimes were to be minimised. However, many significant differences continue to exist between the two.

### **The objectives of restructuring law**

The purpose of restructuring law is to provide an insolvent debtor with a limited but reasonable period of time within which to develop a plan or proposal and present it before its creditors, who must decide to accept or reject it. The objectives of restructuring can be summarised as rescuing financially distressed firms, maximising the values of assets for creditors, and protecting the public interest.

### **Commencing restructuring proceedings**

A decision to initiate a restructuring is of crucial importance. The debtor will usually explore a number of alternatives. The debtor must also determine which restructuring regime may be used if both CCAA and BIA are available. The commencement of restructuring proceedings is accompanied by a stay of proceedings. This gives the debtor a short relief from the enforcement activities of creditors and the opportunity to develop a plan of compromise to put before its creditors for approval. If the creditors convince the court that the liquidation of the debtor is the preferred option and the restructuring attempt should be terminated, the debtor will likely be liquidated through bankruptcy or receivership proceedings.<sup>4</sup>

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4 Wood *Bankruptcy* 1 326.

## Eligible persons

It is necessary to determine whether the debtor meets the statutory eligibility requirements imposed by the insolvency regimes before commencing restructuring proceedings. Both regimes require that the debtor be bankrupt or insolvent.<sup>5</sup>

### Eligibility under the CCAA

The CCAA has stricter statutory eligibility requirements than the BIA. In order to qualify, the debtor must be a "debtor company" and the total claims against it and any affiliated debtor company must exceed C\$5 million.<sup>6</sup> The CCAA defines "debtor company" as a company that is bankrupt or insolvent.<sup>7</sup> The definition of "company" covers federal and provincial corporations, as well as any foreign corporation having assets and doing business in Canada.<sup>8</sup> The CCAA therefore adopts an eligibility criterion that depends upon the legal structure of the business entity.<sup>9</sup>

The C\$5 million threshold limits the availability of the CCAA to larger companies; however, claims against all affiliated companies are combined.<sup>10</sup> "Claims" are defined as any indebtedness, liability, or obligation that would be provable in bankruptcy.<sup>11</sup> This permits the inclusion of unliquidated or contingent claims into the determination.

### Eligibility under the BIA

The commercial proposal provisions in the BIA adopt less restrictive eligibility conditions. The provisions of the BIA are not limited to corporations but apply to persons generally, and individuals and non-corporate business entities can

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5 BIA S 2.

6 CCAA S 3(1).

7 CCAA S 2(1).

8 *Global Light Telecommunications Inc* 2004, 2 CBR (5th) 210 (BCSC).

9 *Wood Bankruptcy* 327.

10 *Wood Bankruptcy* 328.

11 CCAA S 2(1).

restructure under this regime.<sup>12</sup> The BIA does not impose a financial threshold based on the value of outstanding claims against the debtor.

### **Commencing proceedings under the CCAA**

Restructuring proceedings under the CCAA are commenced through an application to a court for an initial order.<sup>13</sup> Although the statute does not require that the debtor company bring the application, it is nearly always the case that the debtor company will initiate the proceedings.<sup>14</sup> An application for an initial order under the CCAA can be made on an *ex parte* basis where there is a chance that creditors will attempt to exercise their enforcement remedies against the debtor's assets before the court hears the matter.<sup>15</sup> The initial application is usually made only with notice to the major creditors.<sup>16</sup> The initial application will usually request an order that authorises the debtor company to continue its business operations and stay in possession of its property, stays proceedings against the debtor company, appoints a monitor, authorises the debtor company to obtain interim financing,<sup>17</sup> authorises the debtor company to file a plan of arrangement, and permits interested parties to apply to the court for variation or amendment of the order (a "comeback" clause).<sup>18</sup>

The stay of proceedings provided for in the initial order cannot exceed thirty days. A subsequent application will be required to extend stay of proceedings.<sup>19</sup> This allows parties affected by the initial order to have an opportunity to express their views concerning the eligibility of the debtor or the appropriateness of the order.<sup>20</sup>

A monitor is an independent third party (a qualified bankruptcy trustee) who monitors the company's ongoing operations and assists with the filing and voting on the plan

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12 BIA S 50(1).

13 CCAA S 11.02(1).

14 *Wood Bankruptcy* 330.

15 *Wood Bankruptcy* 330.

16 *Royal Oak Mines Inc* 1999, 6 CBR (4th) 314 (Ont Ct Gen Div) – hereafter *Royal Oak*.

17 Debtor-in-possession (DIP) financing.

18 *Wood Bankruptcy* 330–331.

19 CCAA S 11.02(2).

20 *Wood Bankruptcy* 331.

of arrangement. The monitor must notify the every known creditor that has a claim of more than C\$1 000 against the company and advise it of the order.<sup>21</sup>

### **Commencing proceedings under the BIA**

Restructuring proceedings under the BIA can be initiated through two routes, neither of which requires intervention of a court in order to commence the proceedings. The first route is taken in instances in which the debtor has already developed a commercial proposal; however, most business organisations are unable to file a proposal in the first instance where they need time to negotiate its terms with their creditors. Accordingly, most commercial entities that restructure under the BIA take the second route. This allows the debtor to initiate proceedings by filing a notice of intention to make a proposal with the official receiver.<sup>22</sup> The trustee is required to notify every known creditor of the notice of intention within five days of its filing.<sup>23</sup>

### **Switching restructuring regimes**

Both the CCAA and the BIA contain provisions that prevent a debtor from invoking the other restructuring regime if the plan or proposal has failed under the regime initially chosen. However, mid-stream jumps between the two regimes are permissible.<sup>24</sup> The BIA provides that proceedings commenced under the CCAA shall not be dealt with or continued under the BIA.<sup>25</sup> Therefore, the BIA proceeding must be commenced afresh through the filing of a notice of intention or a proposal.<sup>26</sup> The CCAA provides that restructuring proceedings under the BIA may be continued under the CCAA.<sup>27</sup> This means that the CCAA initiation proceedings do not need to be commenced afresh and the initial and subsequent applications procedure is not invoked.<sup>28</sup>

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21 CCAA S 23(1)(a).

22 CCAA S 50.4 (1).

23 CCAA S 50.4 (6).

24 *Royal Oak; Mega Bleu Inc/Mega Blue Inc* 2003, 30 CBR (4th) 80 (NBQB).

25 BIA S 66(2)(a).

26 *Wood Bankruptcy* 332.

27 CCAA S 11.6(a).

28 *Wood Bankruptcy* 332.

## Stay of proceedings

A major difference between the stay of proceedings under the CCAA and BIA is that the former is derived from a court order and the latter automatically upon the commencement of proceedings. Therefore, a court in CCAA proceedings is able to tailor the stay of proceeding to address specific problems associated with the particular business.<sup>29</sup> The power given to a court to stay proceedings under the CCAA has been interpreted broadly. The 2005/2007 amendments to the CCAA now provide a separate statutory basis for the exercise of many of these powers. Both acts provide that the Crown is bound.<sup>30</sup>

### Stay of proceedings under the CCAA

Stay of proceedings that is typically granted by a court in CCAA has a broad scope. It prevents any commencement or continuation of proceedings before a court or a tribunal.<sup>31</sup> This includes judicial, extrajudicial, and self-help remedies and is effective against secured and unsecured creditors.<sup>32</sup> The stay does not affect prosecution of criminal or quasi-criminal proceedings against the debtor.<sup>33</sup> However, it applies to enforcement proceedings that are brought to recover a fine or penalty.<sup>34</sup>

In seeking an initial order staying proceedings as well as any subsequent orders, the applicant must satisfy the court that circumstances exist that make such an order appropriate.<sup>35</sup> In obtaining a subsequent order, the applicant must also satisfy the court that the applicant is acting in good faith and with due diligence.<sup>36</sup>

### Stay of proceedings under the BIA

The stay of proceedings under the BIA arises automatically upon the filing of a proposal with a trustee or upon filing of a notice of intention with the official

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29 *Wood Bankruptcy* 333.

30 CCAA S 40.

31 *Luscar Ltd v Smoky River Coal Ltd* 1999, 12 CBR (4th) 94 (Alta CA).

32 *Quintette Coal Ltd v Nippon Steel Corp* 1990, 2 CBR (3d) 303 (BCCA).

33 *Milner Greenhouses Ltd v Saskatchewan* 2004, 50 CBR (4th) 214 (Sask QB).

34 *Air Canada* 2006, 28 CBR (5th) 317 (Ont SCJ).

35 *Wood Bankruptcy* 334.

36 CCAA S 11.02(3).

receiver.<sup>37</sup> Unlike the stay of proceedings under ordinary bankruptcy proceedings, a stay under BIA restructuring proceedings binds both secured and unsecured creditors.<sup>38</sup> When restructuring proceedings are initiated under the BIA through a notice of intention, the automatic stay of proceedings ends upon the filing of proposal.<sup>39</sup> Upon filing of the proposal, a second stay of proceedings automatically comes into operation and ends when the trustee is discharged or the debtor has become bankrupt.<sup>40</sup>

### **Lifting the stay of proceedings**

Creditors might bring a motion to lift a stay of proceedings in an attempt to terminate the restructuring and replace it with some other insolvency regime, such as bankruptcy or receivership.

Where a restructuring is attempted under the CCAA, a creditor can bring an application to lift a stay pursuant to the comeback provision that is typically found in the initial order or subsequent orders.<sup>41</sup> This provision gives an interested person the right to apply to the court to vary or amend the order. The motion can also be brought before the court when the debtor company makes a subsequent application to obtain an extension of the stay beyond the period granted by the initial order.<sup>42</sup>

Where a restructuring is attempted under the BIA, a creditor may apply to a court for a declaration that the stay of proceedings no longer applies to that creditor.<sup>43</sup> The court may make the declaration if it is satisfied that the creditor is likely to be materially prejudiced and it is equitable on other grounds to do so.<sup>44</sup>

Although the CCAA does not articulate the grounds for lifting the stay, the courts apply a similar approach to BIA in deciding if a stay of proceedings should be

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37 BIA S 69.1(1) and 69(1).

38 Wood *Bankruptcy* 334.

39 BIA S 69(1).

40 BIA S 69.1(1)(a).

41 Wood *Bankruptcy* 343.

42 Wood *Bankruptcy* 343.

43 BIA S 69.4.

44 Wood *Bankruptcy* 343.

amended or varied in relation to a particular creditor.<sup>45</sup> Therefore, court will lift the stay where it is satisfied that the creditor is likely to be materially prejudiced and that it is equitable on other grounds. Typically, creditors will seek to convince the court that the application is "doomed to fail".

### **Terminating restructuring proceedings**

Both the CCAA and the BIA allow creditors to apply for termination of restructuring proceedings. Under the CCAA, a general lifting of the stay terminates restructuring proceedings and all of the creditors are entitled to exercise their ordinary remedies against the debtor. This will usually result in the liquidation of the debtor through bankruptcy or receivership. However, these proceedings do not arise automatically and must be initiated by the creditors following the termination.<sup>46</sup> In contrast, a failure of the restructuring proceedings under the BIA will result in automatic bankruptcy of the debtor.<sup>47</sup>

#### **Termination under the CCAA**

There are three methods by which the creditors can bring a request for the termination of the restructuring proceedings before a court. The first is to wait until the debtor applies to court for renewal of the stay of proceedings. A challenge by creditors is most likely to be brought at the hearing of the debtor company's subsequent application for a stay immediately following the end of the period specified in the initial order.<sup>48</sup> There is no limit on the length in time or the number of subsequent extensions to the stay of proceedings that can be granted by a court. Creditors may also choose to seek termination of restructuring proceedings at one of these later extension applications.<sup>49</sup> The second method is to bring an application to the court pursuant to a comeback clause that is typically included in the court order.<sup>50</sup> The third method for challenging the stay of proceedings is to appeal the

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45 *Wood Bankruptcy* 343.

46 *Wood Bankruptcy* 346.

47 BIA S 50(12.1), 50.4(8), 57, 61(2) and 63(4).

48 843504 Alberta Ltd 2003, 4 CBR (5th) 306 (Alta QB).

49 *San Francisco Gifts Ltd* 2005, 10 CBR (5th) 275 (Alta QB).

50 *Algoma Steel Inc* 2001, 25 CBR (4th) 194 (Ont CA).

order. This method is more difficult than the other two because of the high threshold that is applied for this process.<sup>51</sup>

## Termination under the BIA

A debtor who files a notice of intention to make a proposal is given a thirty-day period within which to make a proposal.<sup>52</sup> The debtor may apply to court for an extension, but any extension given cannot exceed forty-five days.<sup>53</sup> An application for an extension of period must be made before the initial or extended time period has expired.<sup>54</sup> The total length of extensions following the initial thirty-day period cannot exceed five months. A failure to make a proposal within six months results in an automatic bankruptcy of the debtor.<sup>55</sup> Creditors who wish to challenge the restructuring proceedings are not required to wait until the debtor makes an application for an extension of the period. They may apply to court for an order terminating the period, which will result in the automatic bankruptcy of the debtor.<sup>56</sup>

## Grounds for terminating restructuring proceedings

Lack of due diligence of the debtor, bad faith of the debtor, unlikelihood of a viable proposal, and material prejudice to the creditors are grounds for terminating restructuring proceedings under the BIA.<sup>57</sup> The grounds that are set out in CCAA are less precise.<sup>58</sup> Lack of due diligence and bad faith on the part of the debtor are grounds for termination.<sup>59</sup> However, the remaining ground is that there are circumstances that make the granting of the order appropriate.<sup>60</sup>

The absence of specific language in the CCAA with regard to the likelihood of a viable proposal and material prejudice to creditors does not mean that these are not

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51 Wood *Bankruptcy* 347.

52 BIA S 50.4(8).

53 BIA S 50.4(9).

54 Wood *Bankruptcy* 347.

55 Wood *Bankruptcy* 348.

56 BIA S 50.4(11).

57 BIA S 50(12), 50.4(9) and 50.4(11).

58 Wood *Bankruptcy* 348.

59 CCAA S 11.02(3)(b).

60 CCAA S 11.02(3)(a).

important. The court is given some leeway under the CCAA to permit restructuring proceedings to continue despite the fact that it may cause prejudice to creditors.<sup>61</sup>

### **a) Lack of due diligence**

Under the CCAA, there is some tendency to grant the initial order as a matter of routine.<sup>62</sup> Thereafter, on applications by the debtor for an extension of the period, the debtor must demonstrate that it is making reasonable progress in the restructuring process. Inability to demonstrate sufficient progress can result in termination of the restructuring proceedings.<sup>63</sup>

### **b) Lack of good faith**

Evidence that the debtor has attempted to mislead the other parties or the court or that the debtor is attempting to use the restructuring for an ulterior purpose are factors that may cause the court to use this ground to terminate restructuring proceedings.<sup>64</sup>

### **c) Doomed to failure**

A plan must be approved by a majority of creditors who have two-thirds of the value of the outstanding claims in order to be accepted.<sup>65</sup> Therefore, a creditor or group of creditors who have more than one-third of the value of the claims of a particular class have a *veto* and are able to defeat the plan.<sup>66</sup> There is no point in incurring the expenses of restructuring proceeding if there is no reasonable prospect that the attempt will succeed. The lack of support of the key creditors together with other evidence, such as inadequate financing or loss of faith in management, may cause a

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61 *Wood Bankruptcy* 349; *Skydome Corp v Ontario* 1998, 16 CBR (4th) 125 para 11 (Ont Ct Gen Div).

62 *Wood Bankruptcy* 349.

63 *Timber Lodge Ltd v Imperial Life Assurance Co* 1992, 17 CBR (3d) 126.

64 *Wood Bankruptcy* 349.

65 CCAA S 6(1); BIA S 54(2) and 62(2)(b).

66 *Wood Bankruptcy* 350.

court to terminate the proceedings on the ground that it has no reasonable chance of success.<sup>67</sup>

#### **d) Material prejudice**

A fully secured creditor must wait until the plan is developed and put before the creditors before it can realise against the collateral, but this on its own is not considered material prejudice that would justify a termination of the restructuring proceedings.<sup>68</sup> There must be material prejudice, such as where proceedings are resulting in a loss of value of the underlying assets so that the creditors will receive less than they would were the assets to be liquidated immediately.

### **Operating the business**

#### **Interim financing**

The term "DIP financing" is used to describe the interim financing required for the ongoing operations of the business during restructuring proceedings. Neither the CCAA nor the BIA originally addressed the issue of DIP financing, and the gap was filled by the courts by exercising their inherent or equitable jurisdiction.<sup>69</sup> The 2005/2007 amendments specifically address interim financing in both the CCAA and BIA restructurings. A court is empowered to make an order declaring that all or part of the debtor's property is subject to a security or charge in an amount that the court considers appropriate.<sup>70</sup>

The statute directs courts to consider the following factors in deciding whether to make such an order<sup>71</sup>:

- (a) the period during which the debtor is expected to be subject to restructuring proceedings;

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67 *Cumberland Trading Inc* 1994, 23 CBR (3d) 225 (Ont Ct Gen Div).

68 *H & H Fisheries Ltd* 2005, 18 CBR (5th) 293 (NSSC).

69 *Wood Bankruptcy* 356–357.

70 CCAA S 11.2(1); BIA S 50.6(1).

71 CCAA S 11.2(4); BIA S 50.6(5).

- (b) the manner in which the debtor's business and financial affairs are to be managed during the proceedings;
- (c) whether the major creditors have confidence in the debtor's management;
- (d) whether the loan will enhance the prospects of a viable plan or proposal being made in respect of the debtor;
- (e) the nature and value of the debtor's property;
- (f) whether any creditor will be materially prejudiced as a result of a security or charge; and the report of the monitor or the trustee as to the reasonableness of the debtor's cash-flow statement.

### **Governance and supervision**

The debtor does not usually lose control over the management of its business during the period in which restructuring proceedings are ongoing. The initiation of restructuring proceedings radically changes the environment within which the debtor manages and operates its business. The debtor must work closely with the monitor, insolvency professionals and expert legal advisors and must engage in a series of negotiations with claimants in order to develop an acceptable plan.<sup>72</sup>

### **The role of the debtor**

Where a debtor is a closely held corporation, a single person or a small group of persons hold a controlling interest in the corporation. These individuals sometimes possess firm-specific knowledge and expertise, which makes it necessary to retain them as participants in the restructured business.<sup>73</sup> Where the shares of the corporation are traded publicly however there is a division between ownership and control. It is often the case that the total value of the creditor's claims exceeds the going-concern value of the financially distressed firm. In such a case, the shareholder's interest will usually be wiped out and they will not be participants in the restructured corporation.<sup>74</sup> Therefore, during the restructuring proceedings, the corporate directors must recognise that it is no longer appropriate for them to focus

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72 Wood *Bankruptcy* 382.

73 Wood *Bankruptcy* 383.

74 *Stelco Inc* 2006, 17 CBR (5th) 78 (Ont SCJ).

upon the interests of shareholders when making their decisions.<sup>75</sup> It may be also necessary to change the current management team where the creditors have lost trust in the management of directors.<sup>76</sup>

### **The role of the monitor and the trustee**

A monitor under CCAA and a trustee under BIA have a similar but not an identical role. They are officers of the court with the primary obligation to ensure that accurate and timely information is provided to the creditors and to the court.<sup>77</sup> A monitor or a trustee has to be a qualified person under the CCAA and the BIA.<sup>78</sup>

Originally, the CCAA did not provide for the appointment of a monitor and therefore a court appointed one by exercising its inherent or equitable jurisdiction.<sup>79</sup> In 1997, the appointment of a monitor was made a mandatory feature of a CCAA restructuring. The primary obligation of the monitor is to monitor the business and financial affairs of the company.<sup>80</sup> A monitor is given a right of access to and examination of the debtor's property for the purpose of monitoring the debtor's business and financial affairs.<sup>81</sup> Specific statutory duties of monitors are set out in CCAA.<sup>82</sup>

A trustee is under a statutory obligation to make an appraisal and investigation of the affairs and property of the debtor in order to estimate with reasonable accuracy the financial situation of the debtor and the cause of the debtor's financial difficulties or insolvency and report the result to the creditors.<sup>83</sup> Specific statutory duties of trustees are set out in BIA.<sup>84</sup>

The monitor and the trustee are given a right of access to and examination of the debtor's property for the purpose of monitoring the debtor's business and financial

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75 *Peoples Department Store Inc (Trustee of) v Wise*, [2004] 3 SCR 461.

76 CCAA S 11.5(1); BIA S 64(1).

77 *Wood Bankruptcy* 388.

78 CCAA S 11.7(1); BIA S 2.

79 *Wood Bankruptcy* 389.

80 CCAA S 11.7(1).

81 CCAA S 24.

82 CCAA S 23(1).

83 BIA S 50(5).

84 BIA S 50,50.4,50.5 and 58.

affairs.<sup>85</sup> They must also act honestly and in good faith and must comply with the code of ethics that governs the conduct of trustees.<sup>86</sup>

Usually the debtor selects the person to act as a monitor or a trustee. However, once that person has been appointed, he/she becomes an officer of the court and only the court has the power to terminate his/her appointment.<sup>87</sup> The CCAA expressly gives the court the power to direct a monitor to carry out other functions.<sup>88</sup> The initial order will usually give the monitor the power to advise the debtor company in the development of its plan and in respect of its meeting with its creditors.<sup>89</sup> Under the BIA, the trustee is expressly given the power to advise the debtor and participate in the preparation of the proposal, including negotiations with the creditors.<sup>90</sup>

Monitors and trustees are given statutory protection from liability. A monitor is not liable for loss caused by a party who relies on a monitor's report if the monitor acts in good faith and takes reasonable care in its preparation.<sup>91</sup> A trustee is not liable for loss caused to any party from that party's reliance on the cash-flow statements if the trustee acts in good faith and takes reasonable care on reviewing those statements.<sup>92</sup> Monitors and trustees are further protected from personal liability and liability arising from environmental conditions that occurred before their appointment, or if the damage was not caused by their wilful conduct or gross negligence after their appointment.<sup>93</sup>

### **The role of the courts**

The traditional view of the difference between the CCAA and BIA restructuring proceedings is that CCAA has a higher degree of court involvement and of judicial discretion than the BIA. The BIA is characterised as being more rule driven and

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85 CCAA S 24; BIA S 50(10) and 50.4(7)(a).

86 CCAA S 25.

87 CCAA S 11.7(3).

88 CCAA S 23(1)(k).

89 *Wood Bankruptcy* 393.

90 *Wood Bankruptcy* 393.

91 CCAA S 23(2).

92 BIA S. 50(9) and 50.4(5).

93 CCAA S 11.8 (1) and (3); BIA S 14.06(1.2) and (2).

therefore less adaptable to larger and more complex restructuring proceedings.<sup>94</sup> However, this conventional view needs to be modified in light of current legislative amendments to both regimes.<sup>95</sup> The amendments to the commercial proposal provisions of the BIA have given the courts the same powers as those available under the CCAA. These powers include the power to authorise DIP financing, authorise the creation of directors' and officers' charge ranking in priority over secured creditors, authorise the creation of an administrative charge ranking in priority over secured creditors, review the disclaimer of contracts by the debtor, authorise the assignment of contracts, authorise the sale of assets outside the ordinary course of business of the debtor, and the power to impose a stay of proceedings in respect of regulatory proceedings.<sup>96</sup>

### **The role of the creditors**

Creditors can strongly influence the direction of the restructuring through bargaining, the use of actual or threatened litigation, and voting on the plan.<sup>97</sup> Creditors may bring application to terminate the restructuring proceedings or to lift the stay of proceedings. In appropriate cases, the courts will approve the formation of a creditors' committee, and its fees will be paid as part of the restructuring costs.

### **Developing and approving the plan**

The aim in a commercial restructuring is to come up with an agreement that will be approved by the creditors. The agreement is termed a "plan of compromise" or "plan of arrangement" in CCAA proceedings and a "commercial proposal" under the BIA (both are referred to as the "plan" in this paper). The plan usually separates the creditors into a number of different classes and it is not binding on any class of creditors, unless it is approved by them. It is sufficient that a majority of creditors who hold at least two-thirds the value of the claims vote in favour of it. A court must then review the plan to ensure that it is not unfair. If the court approves it, the plan becomes binding on all the creditors affected by its terms.

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94 Wood *Bankruptcy* 394.

95 Wood *Bankruptcy* 394.

96 BIA S 50.6, 64.1, 64.2, 65.11(3)-(4), 84.1, 65.13 and 69.6.

97 Wood *Bankruptcy* 399.

## Developing the plan

A debtor who enters into restructuring proceedings must usually attempt to maintain business operations in an environment in which extensive negotiations with lenders may be required, worried suppliers must be reassured, and steps for preservation and operation of the business must be taken. Moreover, the debtor must attempt to negotiate and develop an acceptable plan to all the relevant stakeholders.<sup>98</sup> Therefore, a debtor is faced with a challenge of negotiating a deal under severe time constraints and pressure. The process is made more difficult by the fact that the creditors do not always speak in harmony and are often in conflict with one another.<sup>99</sup>

## Mandatory features of the plan

Both restructuring regimes include a number of mandatory features that must be included in a plan in order to be accepted. Firstly, the plan must provide for the payment in full to Her Majesty within six months after court approval of all the amounts in respect of unremitted source deductions of income tax, Canada Pension Plan deductions, and Employment Insurance.<sup>100</sup> Secondly, the plan must provide for payment to the employees of no less than the amount that the employees would be qualified to claim as a preferred creditor in the event of a bankruptcy together with all amounts earned after the commencement of restructuring proceedings.<sup>101</sup> Thirdly, the plan must provide for the payment of unremitted pension contributions.<sup>102</sup>

## Approval by the creditors

Restructuring proceedings may involve intense negotiations between the debtor and the creditors. During the negotiation stage, the draft plan may be significantly modified. There is no limit on the number of modifications and amendments that can

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98 Wood *Bankruptcy* 421.

99 Wood *Bankruptcy* 421 and 422.

100 CCAA S 6(3); BIA S 60(1.1).

101 CCAA S 6(5); BIA S 60(1.3).

102 CCAA S 6(6); BIA S 60(1.5).

be made during this stage.<sup>103</sup> Once the plan has been sufficiently developed, a meeting of creditors is called so they can vote on the plan.<sup>104</sup> The CCAA provides that a court may order a meeting of the creditors but provides very little guidance on the process. The detail is supplied by the court in a meeting and approval order that establishes the procedure for the calling and holding of a meeting of the creditors to vote on the plan.<sup>105</sup> The CCAA provides that the court may adjourn a meeting of creditors if an alteration or modification of the plan has been proposed after the court has ordered a meeting.<sup>106</sup>

The BIA contains a set of rules that directs the calling of a meeting of creditors. The trustee must call the meeting within twenty-one days of the filing of the proposal with the official receiver<sup>107</sup> and the rules governing meeting of creditors under the BIA are applicable.<sup>108</sup> The chair may adjourn the meeting to permit further investigation or examination.

### **Unaffected creditors**

Both statutes provide that the plan must be approved by a majority of creditors representing two-thirds of the value of the claims.<sup>109</sup> A plan does not need to address all of the creditors and those that are left unaffected have no right to vote on it.<sup>110</sup> Unaffected creditors enjoy their full legal rights once the restructuring has been completed and stay of proceedings has been lifted.<sup>111</sup> The CCAA does not contain any restriction as to the kinds of parties that may be designated as unaffected under a plan. Under the BIA, a proposal must be made to all unsecured creditors, thus it is not possible to leave a class of unsecured creditors outside a proposal.<sup>112</sup> The BIA provides that a proposal "may" be made to secured creditors.<sup>113</sup>

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103 Wood *Bankruptcy* 423.

104 Wood *Bankruptcy* 423.

105 Wood *Bankruptcy* 425.

106 CCAA S 7.

107 BIA S 51(1).

108 Wood *Bankruptcy* C-8 A(1).

109 CCAA S 6(1); BIA S 3, 54(2) and 62(2)(b).

110 Wood *Bankruptcy* 427.

111 Wood *Bankruptcy* 427.

112 Wood *Bankruptcy* 427.

113 BIA S 50(1.3).

The CCAA is silent on the question of partial acceptance. In *Olympia & York Developments Ltd v Royal Trust Co*,<sup>114</sup> the plan specifically provided that if a class of creditors voted against the plan that class would drop out of the plan. Therefore, the class of creditors that voted for the plan were bound and those that voted against it were unaffected by it. However, this becomes more difficult where the plan is silent on this matter and the court must determine the intention of the parties.<sup>115</sup>

All classes of unsecured creditors must approve the proposal under the BIA.<sup>116</sup> A vote against the proposal by any class of unsecured creditors will cause the plan to fail and the court will be unable to approve the proposal.<sup>117</sup> The BIA provides that the proposal is only binding on secured creditors if they approve the plan by dual majority.

Under both CCAA and BIA, if a creditor is related to the debtor, the creditor may vote against the plan but not for the acceptance of it.<sup>118</sup> This is because the non-related parties may be concerned that the related party will vote in favour of the plan for approval, whereas the exclusion of their votes would result in a rejection of the plan.<sup>119</sup>

### **Classification of creditors**

The CCAA and the BIA provide for the creation of classes of creditors for the purposes of voting on the plan, which includes the classification of both secured and unsecured creditors.<sup>120</sup> These statutory rules are largely codifications of the judicially created principles and therefore it becomes necessary to review the case law to fully understand the rational and logic behind them.<sup>121</sup> *Sovereign Life assurance Co v Dodd*<sup>122</sup> states that the rational for placing creditors into different classes is that "the creditors composing the different classes have different interests; and, therefore, if

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114 1993, 17 CBR (3d) 1 (Ont Ct Gen Div) – hereafter *Olympia & York*.

115 *Wood Bankruptcy* 428.

116 BIA S 54(2)(d).

117 *Wood Bankruptcy* 428.

118 CCAA S 22(3); BIA S 54(3).

119 *Wood Bankruptcy* 429.

120 CCAA S 22.

121 *Wood Bankruptcy* 434.

122 [1892] 2 QB 573 (CA) 580 per Lord Escher – hereafter *Sovereign*.

we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes." The following test has been utilised to determine whether a classification scheme is fair and reasonable:

It seems plain that we must give such a meaning to the term "class" as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.<sup>123</sup>

Whereas the classification scheme under the CCAA applies to both secured and unsecured creditors, the scheme under the BIA addresses secured creditors only.<sup>124</sup> The statutory provisions allow the classification of creditors if their interests are sufficiently similar to give them a commonality of interest, taking into account the following factors: the nature of the debts giving rise to the claims, the nature and rank of any security in respect of the claim, the remedies available to the creditors in the absence of the plan and the extent to which the creditors would recover their claims by exercising those remedies, the treatment of the claims under the plan and the extent to which the claims would be paid under the plan, and such further criteria consistent with the foregoing.<sup>125</sup> The statutory formulation also provides that a relevant consideration is the nature of the debts giving rise to the claims.<sup>126</sup>

### **Objecting to the classification scheme**

A claimant who is dissatisfied with the fairness of the plan may seek an order calling for the use of a different scheme. The CCAA provides that the debtor must apply to the court for approval of a classification scheme for voting at a meeting.<sup>127</sup> The BIA provides that a court, on application made at any time after a notice of intention or proposal is filed, may determine the classes of secured claims appropriate to a proposal.<sup>128</sup> Although there is no similar provision in respect of unsecured creditors

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123 *Sovereign* 583, Lord Bowen.

124 CCAA S22(2); BIA S 50(1.4).

125 Wood *Bankruptcy* 442.

126 Wood *Bankruptcy* 442.

127 CCAA S 22(1).

128 BIA S 50(1.5).

that object to the classification scheme in a proposal, a court may permit a similar procedure to be followed.<sup>129</sup>

### **The treatment of shareholder claims**

The restructuring regimes only deal with voting on a plan by creditors, and do not make any provisions with respect to shareholders. The CCAA provides that the provisions of any federal or provincial legislation that authorises or makes provisions for the sanction of compromises or arrangements between a company and its shareholders may be applied in conjunction with the Act.<sup>130</sup> The BIA does not contain a similar provision. Under both regimes, a court may order that the constating instrument be amended to reflect any changes that may be lawfully made under federal or provincial law.<sup>131</sup> The question that arises in any restructuring proceeding is whether shareholder approval is needed to implement the restructuring plan (that is, approval for specific transactions, amalgamation, fundamental changes, and so forth). The shareholders will generally be able to receive some consideration or maintain some participation in the restructured corporation as the price for obtaining their consent to the transaction if their approval is needed.<sup>132</sup> Shareholders may legitimately expect to participate in the restructuring if there is a reasonable possibility that their interests retain some value.<sup>133</sup>

### **Approval by the court**

The court must approve the plan before it becomes binding on the creditors. The court will consider the report of the trustee or the monitor before approving or rejecting the plan.<sup>134</sup> The court may not approve a plan if the creditors have rejected it. A plan's fairness and reasonableness are critical under both restructuring regimes.<sup>135</sup>

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129 Wood *Bankruptcy* 442.

130 CCAA S 42.

131 CCAA S 6(2); BIA S 59(4).

132 Wood *Bankruptcy* 443.

133 Wood *Bankruptcy* 444.

134 CCAA S23 (1)(i).

135 Wood *Bankruptcy* 446.

The CCAA provides that a court may sanction a plan that has been approved by the creditors, but it does not provide any criteria to assist a court in making that decision. The relevant considerations that have been developed in a series of decisions are that there must be strict compliance with the statutory criteria, there must be no unauthorised conduct, and the plan must be fair and reasonable.<sup>136</sup>

A different set of criteria are to be applied by a court in deciding whether to approve a proposal under the BIA. A court is directed to refuse a proposal if the terms of the proposal are unreasonable or the terms of the proposal are not calculated to benefit the general body of creditors.<sup>137</sup>

Generally, in deciding whether to approve or refuse a plan, the courts consider procedural fairness, amount of recovery in comparison to liquidation, changes in priority ranking, composition of the vote, and the likelihood of elimination of financial crisis under the plan.<sup>138</sup>

### **The legal effect of approval or rejection**

A plan binds every creditor in each class of creditors that voted in favour of it when a plan has been approved by the creditors and by a court. It does not bind unaffected creditors or classes of creditors that voted against the plan. Upon court approval, the obligations owed by the debtor to affected creditors are discharged and replaced with the obligations that are provided for in the plan.<sup>139</sup>

A refusal of a proposal by the unsecured creditors results in an automatic bankruptcy of the debtor under the BIA.<sup>140</sup> Therefore, each class of unsecured creditors must approve the proposal. The rejection of proposal by one or more classes of secured creditors does not have the same effect and the dissenting classes will be treated as unaffected creditors.<sup>141</sup>

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136 *Northland Properties Ltd v Excelsior Life Ins Co of Can* 1989, 73 CBR (NS) 195 (BCCA); *Olympia & York*.

137 BIA S 59(2).

138 *Wood Bankruptcy* 447–450.

139 *Wood Bankruptcy* 450.

140 BIA S 57.

141 BIA S 62(2).

The CCAA does not provide for an automatic bankruptcy or for the automatic termination of the stay of proceedings upon refusal of the plan by the creditors. Creditors need to bring an application before the court to terminate the stay of proceedings or wait until the designated period for the stay of proceedings expires.<sup>142</sup> They may apply for a bankruptcy order or otherwise enforce their claims against the debtor.

### **Post-approval default**

The treatment of post-approval default under the CCAA is relatively straightforward.<sup>143</sup> A default under new obligations will give the creditors the normal enforcement remedies associated with those rights. The debtor may attempt to initiate a second round of restructuring proceedings if the financial crisis is not improved.

The situation under BIA is more complex. Proposals that are made with respect to smaller corporations are more likely to involve terms that require future performance, such as putting a lease into good standing or making certain future payments in keeping with the proposal. The BIA provides a system for judicial annulment of a proposal, which is significant, since it will result in the automatic bankruptcy of the debtor.<sup>144</sup> A court may annul a proposal if there has been a default under the terms of a proposal, if the court is of the opinion that the continuation of proposal results in injustice,<sup>145</sup> if the approval of the court was obtained by fraud, or if the debtor has been convicted of bankruptcy offence.<sup>146</sup> The power to annul a proposal is discretionary and therefore the court is not required to order an annulment on a default in performance.<sup>147</sup> An annulment of a proposal does not affect the validity of any sale, disposition of property, or payment duly made or done under or in pursuance of the proposal.<sup>148</sup>

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142 Wood *Bankruptcy* 451.

143 Wood *Bankruptcy* 451.

144 BIA S 63(4).

145 *Garrity* 2006, 21 CBR (5th) 237 (Alta QB).

146 BIA S 63(1) and (3).

147 Wood *Bankruptcy* 452.

148 BIA S 63(2).

**Conclusion**

From personal experience, I can assure you that in Canada the legislation for the restructuring of insolvent corporations works very well. It serves to save thousands of jobs every year, and has resulted in countless insolvent corporations being resurrected and restored to excellent financial health. Effective restructuring legislation in South Africa is to be encouraged.

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*List of abbreviations*

BIA	Bankruptcy and Insolvency Act
CCAA	Companies' Creditors Arrangement Act
DIP	Debtor-in-possession