

# INSOLVENCY 101 & 201

December 3, 2008

By: Peter D. Wedlake, FCIRP

G R E E N  
**hunt | wedlake**

INSOLVENCY CONSULTANTS | BANKRUPTCY TRUSTEES

# Contents

## Insolvency 101 – Bankruptcy & Receivership

- Definitions
- Why do businesses fail
- Alternatives
- Impact of Bankruptcy/Receiverships on creditors

## Insolvency 201- Restructuring a Business

- Foundations to success
- Options in a restructuring
- Choosing between BIA & CCAA

# Definitions

## Bankruptcy and Insolvency Act (BIA)

- Insolvent:
  - Has liabilities in excess of \$1,000
  - Unable to meet obligations as they generally become due
- Bankrupt
  - A corporation/individual who made an assignment or was petitioned

# Definitions

## Receivership

- Secured Creditor initiates action pursuant to a security agreement
- Provides a Section 244 (BIA) – 10 day Notice
- Not bankrupt

## Receiver

- A person appointed to take possession or control pursuant to a Security Agreement
- Of all or substantially all of assets of an insolvent
- Court can appoint a “receiver”

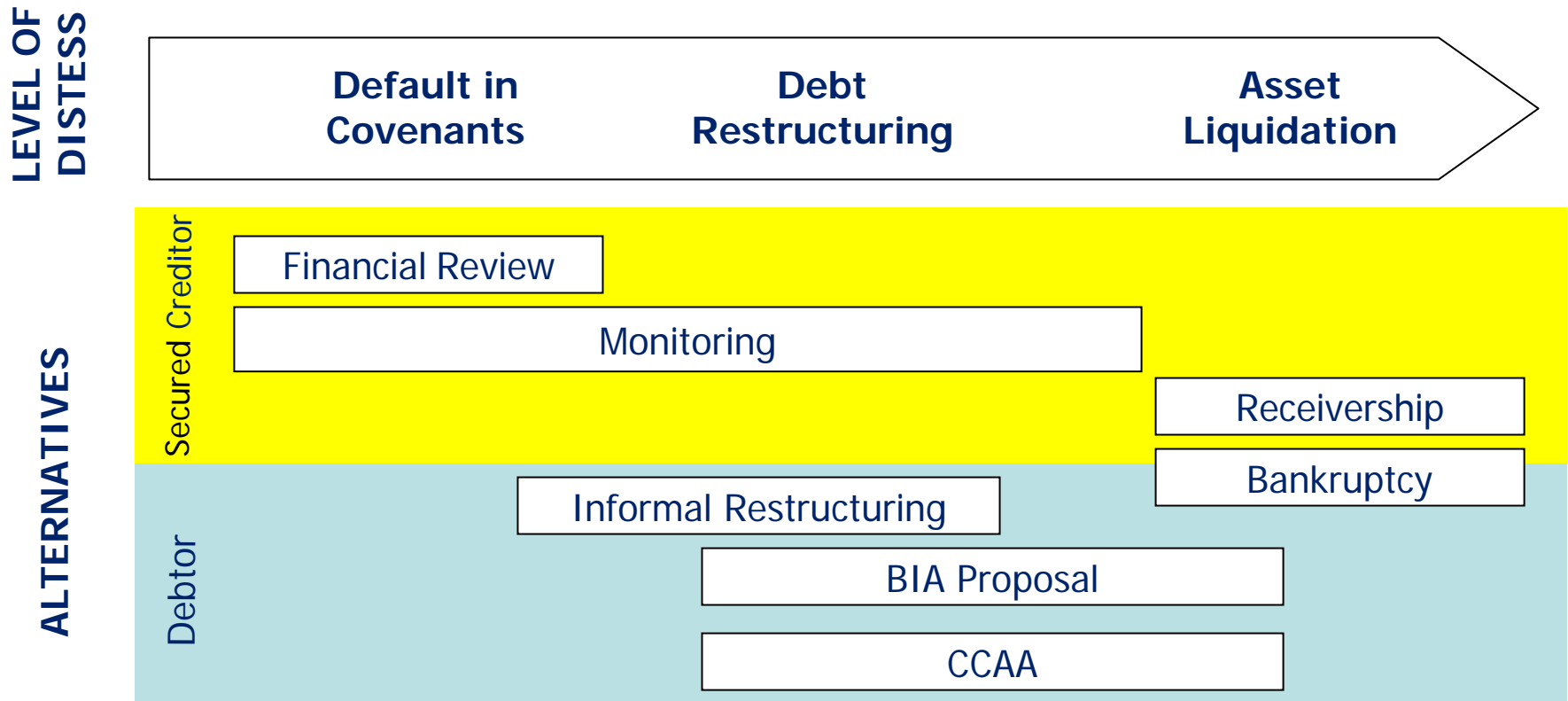
## “Filing for protection”

- BIA Notice of Intention
- BIA Proposal
- Companies Creditor Arrangement Act “CCAA”

# Why do businesses fail?

- Under-capitalization of business
- General downturn in the economy
- Loss of a major customer that's not replaced
- Theft/fraud
- Poor management:
  - Competence
  - In adequate financial information
  - Off-side with bank's covenants
- No business case

# Alternatives Relative to Level of Financial Distress



## Alternatives for the Debtor

### • Informal Restructuring

#### Advantages:

- Lower costs
- No court filing or formal structure
- Creditors may receive more
- Greater flexibility
- Avoid stigma

#### Disadvantages:

- No stay of proceedings
- Must negotiate with each creditor separately
- No formal proceeding reduces strength
- Preferences
- No cram down



## Alternatives for the Debtor

### • Bankruptcy

#### Advantages:

- May provide greater value to stakeholders if operations not viable
- Management/shareholders can exit
- Orderly liquidation as provided by BIA

#### Disadvantages:

- Creditor driven process
- Going concern sale more difficult
- Exposure for directors

## Alternatives for the Debtor

### • Formal Restructuring Through BIA or CCAA

#### Advantages:

- Third party monitoring adds credibility
- Court involvement adds transparency
- Ability to compromise claims against directors
- Can repudiate contracts
- Stay of proceedings
- Debtor in possession (DIP) financing
- Majority rules

#### Disadvantages:

- Higher costs
- More restrictive in dealing with specific creditors
- Less control

## Bankruptcy or Receivership

- Impact on creditors
- Crown Claims:
  - In Bankruptcy:
    - All Provincial statutory liens (i.e. WCB, labour standards, business occupancy) – lose their statutory lien status
    - Canada Revenue Agency
      - HST – unsecured
      - Source deductions – “super-priority”
  - In Receivership:
    - All Provincial and Federal liens are enforceable

## Bankruptcy or Receivership

- Impact on creditors

- Secured Creditors:

- Bankruptcy process is subject to the rights of secured creditors

- Trade debt – often no recovery;

- Suppliers:

- 30 day goods;
- Farmers/fishers/aquaculturists
- Builders Lien Act

## Bankruptcy/Receivership

- Impact on creditors

- Landlord:

- In Bankruptcy Trustee has:

- Right to occupy/terminate a distraint
    - Obligation to pay occupation rent
    - Right to assign lease
    - Right to disclaim lease

- In Receivership:

- No statutory rights to Receiver
    - Must abide by lease

## Bankruptcy/Receivership

### • Director's Liabilities

- Personally liable for:

- HST
- Source deductions
- Workers' compensation
- Trust claim in Builders Lien Act
- Unpaid wages

# Insolvency 201 - Restructuring A Business

- Foundations to a Successful Restructuring
  - A fundamentally good business;
  - Knowing what went wrong and how to fix problems;
  - Debtor has ability to execute plan;
  - Availability of cash during restructuring period;
  - Controlling cash during restructuring;
  - Communications with stakeholders;
  - Integrity and capability of management;

## •Options in Restructuring

- Extension of time to repay debts (repay in full over time);
- Settlement of a percent on the dollar;
- Convert debt to equity;
- Injection of new cash;
  - Shareholder investment;
  - New equity players;
  - Sale of redundant assets;
  - Government assistance;
- Cease unprofitable operations;
- Acquisition of the business by a strategic partner;
- Liquidation proposal



# Choosing between BIA & CCAA

## In General

- Large commercial businesses best restructured under Companies Creditor's Arrangement Act (CCAA).
- Use Bankruptcy & Insolvency Act (BIA) process when costs are a motivating factor.

# Choosing between BIA & CCAA

## Making The Choice

A number of factors to consider:

- Current business operations – key suppliers
- Who are the customers, how will they respond?
- How are ongoing operations going to be financed during the restructuring?
- Nature of debts, particularly secured debt and their enforcement rights.
- Venue
- Cross Border Assets

# Choosing between BIA & CCAA

## Some Factors to Consider

### Eligibility

#### CCAA

- Must be a body corporate
- Must owe at least \$5 million

#### BIA

- Must be an insolvent person
  - wider definition
  - Partnerships
  - Cooperative
- \$1,000 debt threshold

# Choosing between BIA & CCAA

## Role of Monitor/Trustee

### CCAA

- Monitor
- Reporting obligations to the Court
- Reports are subject to greater scrutiny (cross examination)
- Significant legal costs

### BIA

- Trustee
- Works with Company to draft restructuring plan
- Reports to creditors not the Court
- Can appear in Court without counsel on matters
- Lower legal costs



## Claims Process

### CCAA

- Costly
- Process set out by the Court

### Advantages

- Post filing claims (employee's)
- Realty leases can be disclaimed
- Executory contracts can be disclaimed
- Claims Bar date

### BIA

- Process is predefined by BIA
- Realty leases can be disclaimed

### Disadvantages

- No Claims Bar date

# Choosing between BIA & CCAA

## Debtor in Possession Financing (DIP)

### CCAA

- In the Court's discretion
- Well established Court can use its inherent jurisdiction to give priority for such financing

### BIA

- Current provisions of BIA do not provide for DIP financing
- Have been a few cases in Canada (unopposed)
- New amendments propose "Interim Financing"

# Choosing between BIA & CCAA



NOVA SCOTIA  
BARRISTERS' SOCIETY

## Stay Provisions

### CCAA

- Based on Court Order
- Initial order made ex parte
- Initial order - 30 days
- No limit on extensions

### BIA

- Stay is statutory under the Act; No Court Order needed
- Initial Stay is for 30 days
- Can apply to Court for extensions (45 days)
- Maximum stay 6 months

# Choosing between BIA & CCAA

## Rights of Secured Creditors

### CCAA

- Court has broad power to affect the rights of secured creditors
- Generally all classes of creditors must approve

### BIA

- Ability to affect rights of secured creditors is more limited
- Difficult to impose a Proposal on a secured creditor
- Secured creditor can vote against a proposal without proposal failing



# Choosing between BIA & CCAA



NOVA SCOTIA  
BARRISTERS' SOCIETY

## Realty Leases

### CCAA

- Can be repudiated with Court approval
- Consequences dealt with in the plan

### BIA

- Can disclaim lease with 30 days notice
- Landlord can challenge disclaimers
- Test - viable proposed is not possible without the disclaimers
- Calculation of landlord's claims set out by statute

# Choosing between BIA & CCAA

## Government Claims

### CCAA

- Deemed trust portion of source deductions must be paid within 6 months of Court sanction of the plan
- GST/HST remains a deemed trust

### BIA

- Source deductions must be dealt with as with CCAA
- GST/HST becomes an unsecured claim

# Choosing between BIA & CCAA

## Rights to Disclaim/Repudiate Contracts

### CCAA

- Contracts can be terminated by Company
- Consequences dealt with under the plan
- Subject to Court approval

### BIA

- Right to disclaim or repudiate contracts limited

## Costs & Procedure

### CCAA

- A legally driven process
- In Court for:
  - Initial application and Stay
  - All subsequent orders
  - Cash Flow filing
  - Monitor's reports to Court
  - DIP Application(s)

### BIA

- No initial Court process required
- Process is easy to start
- File a Notice of Intention
- Automatic acceptance of filing and Automatic Stay
- No provisions for DIP financing

## Costs & Procedure (Cont'd)

### CCAA

- Cash Flow projections subject to greater scrutiny as they are filed with the Court
- No automatic bankruptcy if plan rejected by the Court or creditors
- WEPPA does not apply
- Administration charge is a super priority

### BIA

- Extensions can be obtained without legal counsel
- No provisions/security for an administration charge for professional fees
- Automatic bankruptcy if proposal is rejected by the creditors or the Court

# Choosing between BIA & CCAA

## Liquidation Proposals

### CCAA

- Questionable as to whether it is a proper use of the statute

### BIA

- Time frames with the BIA are well defined and it is a relatively quick process
- Fairly common where:
  - There is a going concern value to the assets or operations
  - Bankruptcy would result in forfeiture of assets

# Choosing between BIA & CCAA

## Comparison of Plan Requirements

### CCAA

- Very few requirements as to what must appear in the plan
  - Source deductions

### BIA

- Proposal requirements are rigid
- Preferred claims to be paid first and in full
- Crown claims must be paid
- Employees must be paid their preferred claim immediately after Court approval
- All payments must flow through the Trustee
- Levy is payable to Superintendent of Bankruptcy

# Choosing between BIA & CIA

## Consequences of Failure of Plan

### CCAA

- Nothing happens automatically
- Stay will be lifted
- Next step usually bankruptcy

### BIA

- Deemed Assignment in Bankruptcy if Proposal is rejected
- If proposal is in default Court can annul the proposal