

Receiverships and Interim Receivers

CAIRP Tutorial

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Appointment Issues

Private

- Less powers than Court Appointment
- Engagement letters and conflict checks are done in advance of appointment
- Indemnities are requested, however not likely obtained
- BIA protects Receiver and limits exposure to funds held by Receiver unless negligent

Court

- Conflict checks done in advance of appointment
- Lenders are the moving party, once appointed you represent all creditors
- Court order protects Receiver unless negligent
- No indemnity provided by lenders, rely on court order to protect your fees
- Foreign proceedings

Private & Court Appointments

Private Appointment

- Deemed agent of Company by security agreement
- Ensure Receiver has authority to possess and realize on security
- Liability for the Receiver's actions in doing so does not fall to secured holder
- Agent of security holder but agent for company when it comes to dealing with third parties
- Appointment of Receiver is a change of management, however employees not automatically terminated
- Section 244 and 245 of BIA 10 day notice unless the director waives

Court Appointment

- Officer of the court
- Receiver needs to deal with employees, model order does not typically terminate
- Receiver operates beyond the terms of the order, Receiver is not indemnified unless he can conclusively demonstrate that his actions were required to discharge the Receiver's duties
- Ex parte applications possible

Power/Duties of Receiver

Private Appointment

Duty – to preserve and protect the assets covered by the security agreement and to realize on those assets for the benefit of the appointing creditor

Power – as specified in security documents and powers and privileges of Receiver follow from fact that appointment is the exercise of a **contractual remedy** including:

- Taking possession
- Managing property
- Collection of Book of Debts
- Sell assets subject to security
- Borrow if required to protect secured creditors' interest in assets
- Court can interject

Court Appointment

Duty – as an officer of the court required to follow the court's direction

Power – As specified in court order.

Examples:

- Take possession of assets
- Borrow money and secure book debts
- Make sales and incur obligations
- Sale of assets subject to court approval
- Apply to court for direction
- Manage assets of company
- Settle and compromise obligations

Power/Duties of Receiver

Private Appointment

Duties

- Primary to debenture holder
- Manage operations and protect security
- Notify debtor and serve a copy of appointment
- To account on realization of assets to secured holder and debtor
- Act honestly, good faith, commercially reasonable manner
- Standard of care to:
 - Appointing creditor
 - Creditors
 - Corporation
 - Guarantors

Court Appointment

Duties

- Fiduciary responsibility to all interested parties on a fair and reasonable basis, not just the applicant
- Complete powers set out in court order
- Duty to court and other creditors generally but not to any individual creditor above the others
- Preserve goodwill of company by continuing its business unless otherwise authorized by the court (private only due care)
- Instructions from court rather than security documents

Power/Duties of Receiver

- Develop a checklist to ensure all matters are addressed

Notice of Appointment to:

- Attend debtor's premises and serve notice of appointment. If several locations, ensure someone is notified in person at each location.
- Send notice, within 10 days of appointment, to all creditors. If Bankrupt, to **trustee**.
- Inform landlords – must decide whether to occupy or remove security from premises to avoid landlord issues and expensive leases. Watch for landlord distraining after appointment (Private appointment).
- A receiver is defined in Section 243(2) of the BIA, essentially, under any act that appoints a receiver Section 243(2)(b)(ii), BIA treats as a Receiver. Makes a difference for WEPP as well.

Power/Duties of Receiver

Initial Meeting with Management

- To gain co-operation from management on the whole receivership process
- To obtain information on matters which require immediate attention
- Advise management on what is expected of them
- Seek management's input on matters concerning employees, WIP, other contracts (termination of employees not essential to ongoing operations)
- Input should be sought as to continued operations such as WIP conversion

Safeguarding of Assets

- Need to move quickly to get assets under control, need for security guards
- Receiver should be aware of all locations of debtor's operations
- Review security documentation to determine which assets fall within security and interests of other parties

Power/Duties of Receiver

Physical Security of Assets

- Change locks (**sign of taking possession, be careful--review case law**)
- Make a list of persons holding keys and have them sign the list
- Initially, Receiver's staff should have keys and later, others
- Consider if security guards are needed
- Changing codes for security alarm and if one not present, consider installing one
- It may be necessary to store assets at third party location
- Make appropriate arrangements with utilities and landlords, if using premises

Assets at Third Parties

- Notify third parties the assets are Receiver's and arrange for their pickup
- Notify third parties that assets cannot be removed without Receiver's consent
- Be aware of various liens such as warehouseman liens, mechanics lien, etc.
- Section 81 claims

Assets of Third Parties

- Third party assets held until title proven, consignment agreements

Power/Duties of Receiver

Accounting Records

- Secure them immediately and change passwords on computer system
- Move all backups off site
- Disconnect remote access to system
- Instruct accounting staff to bring key records up to date
- Retain records for PST/GST /HST audits and payroll records for separation slips and government audits
- Decide whether the present reporting system is adequate

Power/Duties of Receiver

Dealing with Employees

- Determine the number of employees and consider the termination and severance pay amounts that may come due
- Before possession determine the wage arrears and find out from the secured party whether they will pay them.
- Have a meeting if union reps, consider standstill agreement
- Decide whether to retain employees; must be careful to avoid successor employer obligation (consult with labour lawyer)
- Have retained employees sign contract with Receiver (Term and Task Contracts)
- CRA will want deductions taken off, RP2 account might be necessary

Power/Duties of Receiver

Banking

- Identify all bank accounts (look for accounts not known to Secured Creditor)
- Take possession of all accounts and cheques, cash
- Close old accounts and open new accounts in the name of Receiver in order to avoid post-dated cheques clearing, etc.
- Make account deposit only as another option
- Determine who signing authorities from Receiver's office should be

Book Debts

- Get complete list of all A/R
- Sell based on c.o.d. basis but ensure that all set-off and warranty issues are settled
- Receiver should keep separate records
- Send letter to every known A/R in order to prevent other parties from collecting, consider collection agency
- Receiver should be aware of trust funds and their rights.

Power/Duties of Receiver

Inventory & Fixed Assets

- Obtain copy of last physical inventory
- Do physical count at each location (Follow Directive 7 BIA)
- Inventory fixed assets in a manner to put in sale documents
- Use photographs, video and digital camera
- Must watch section 81.1 and 81.2 for 30 day goods within 15 days of appointment
- Control movement of goods in and out of premises
- Ensure all controls are in place and relationships with new customers are reviewed before commencement of shipments
- Put controls in place to ensure that no goods or services are accepted without the Receiver's knowledge or prior authorization

Power/Duties of Receiver

Opening Mail

- Have one staff of Receiver responsible for mail (consider mail redirect to Receiver's office takes 10 days to come into effect)

Insurance

- Notify insurance company and get acknowledgement Receiver added to policy
- Confirm amount of coverage and adequacy
- Much cheaper to work with the existing company than the Receiver obtaining their own coverage
- Try to use local insurance companies, much cheaper

Power/Duties of Receiver

Costs

- Court Appointed – Taxation, watch subordinate creditors objections to fees
- Private Appointment – usually less expensive, from proceeds of sale of assets subject to secured creditor's approval. If there are no funds available, secured creditor would pay if negotiated prior to appointment.

Reporting

- Section 246 requires interim reports every six months
- Can combine 245/246 when taking possession and control of assets
- Final report 246(3) required upon completion of engagement
- For Court appointed must provide reports to the court including final

Discharge

- Court Appointed – Order directing distribution and providing accounting
- Private Appointed – by letter from secured creditor after receives statement of receipts and disbursements

Continuing Operations

Decision to Operate or Not

- Need to decide either to operate for a short period of time to sell as a going concern or liquidate immediately
- Use of future cash flows to assist in decision to operate
- If operating monitor closely and compare to budget/cash flow
- Sell by private sale, request for proposals, sale by tender or public auction

Selling as going concern/operating:

- Improves realizations on raw materials
- Improves recoveries on accounts receivable
- Machinery and equipment will likely be maintained
- Possible premium added to selling price since goodwill maintained
- Disadvantages:
 - Increased payroll costs and successor employer issues
 - Product warranty, if not offered will affect sales
 - Increased professional fees
 - Environmental issues
 - Lack of customer/supplier/key management support

Legal Advice

Appointing Creditor is required to obtain the appropriate legal advice

As Receiver and Manager, you should obtain a copy of the legal opinion or at least some comfort that the security has been vetted, obtain an indemnification from the secured creditor and proceed on direction provided by secured creditor (Private Appointment)

For court appointment, you will need an independent opinion

Legal issues to review before commencement of engagement:

- Is the security valid and enforceable, have demands been made and have the periods expired (Section 244 BIA and PPSA Notices if applicable)?
- Was there a default pursuant to the terms of the security documents and was consent provided by the debtor?
- Does the security provide for the ability to appoint a Receiver?
- If the security granted to the appointing creditor is not a GSA, does it provide a specific description of the assets encumbered?

Legal Advice – Cont.

Private appointments – have demand letters been sent by the secured creditor and have the security agreements been vetted by the creditor's solicitor?

In private appointments there is no stay of proceedings, however, debtor can refuse access to the secured assets and therefore we must be prepared to proceed to court in order to obtain an Order of the Court granting the Receiver the power to seize the encumbered assets (after 10-day period has expired)

Typically legal representative works for both Receiver and Creditor

Court-appointed Receivers - require leave before legal proceedings can be commenced. It is important to get any legal issues dealt with in the court order since you will be required to appear before court each time you need the Court Order changed thus increasing costs and delays. Toronto has model order

Make sure legal representative has sent PPSA notices (if required)

Legal Advice – Cont.

- **Other duties of legal Advisor:**

- Review security documents
- Review and draft agreements of purchase and sale
- Assist in settlement of accounts receivable and dispute situations
- Enforcement of rights of secured creditor and Receiver
- Help in preparation of standstill agreements
- Review of tender documents
- Construction lien resolution
- Provides creditability in:
 - Court, dealing with third parties, environmental issues

Priority Creditors

Employee Source Deductions

- Section 227 of Income Tax Act (new 12R approved)
- Ranks in priority to claims of all secured creditors except for charges on real property
- Priority as well to Receiver's fees
- If no indemnity provided, must ensure sufficient assets available
- Bankruptcy of debtor does not reduce the priority, however reduces employers portion to unsecured
- Clearance certificate required, watch real property issues.
- Ranks in priority to WEPPA

Goods and Services Tax

- Section 224, cannot pay secured creditor unless paid
- Same as above, however bankruptcy of debtor will reduce priority

Provincial Sales Taxes

- Ranks in priority to claims of secured creditor except for real property (Directive 12R is not applicable)
- Watch for registration on title of real property
- Similar to source deductions and GST
- Clearance certificate required

Priority Creditors – Cont.

Wage Earner Protection Program Act (“WEPPA”)

- Means wages owing to an individual by an employer who becomes bankrupt or there is an appointment of a Receiver pursuant to Section 243 of the BIA
- The maximum claim against assets is \$2,000 per employee plus \$1,000 in disbursements for traveling sales persons which were incurred within 6 months of the company’s failure
- Ranks in priority to secured creditor
- Employee claims against program is approximately \$3,946 maximum and an amount equal to 4 times the maximum insurable earnings under the Employment Insurance Act. (net to employee after deduction of 6.83%)
- **Claims against current assets, only, if none, then preferred**
- **Watch out for mass termination rules**
- Creates priority for any unremitted employee pension contributions in respect of a defined benefit pension plan. **Priority over all assets.**
- Unpaid normal costs as required by legislation in respect of defined contribution plan
- T-4 from HRDC

Priority Creditors – Cont.

- 30 day claims for inventory ranks in priority
- Termination pay and severance pay not in priority to secured creditor but is part of claim provable to HRDC by employee
- Our obligation is to submit values to assist employee to make claim
- Employee remuneration charge is in addition to WEPPA but does overlap the wages and vacation pay portion

Excluded parties from making a WEPPA claim are:

- Directors
- Person who controls 40% of company, EI exempt
- Managers who make decisions to operate company
- Parties not dealing at arms length

Priority Creditors – Cont.

Landlords

- Landlord can distrain after Receiver's appointment
- Must negotiate with landlord to occupy premises to complete receivership
- If debtor is in arrears, bankruptcy will stay the landlord
- Need to assess landlord issues before commencement of receivership or risk losing assets to landlord

Employees

- Employment Standards Act provides priority for salaries and vacation pay (Director Obligation pursuant to CBCA)
- If continuing to operate must consider effects of employees not working until arrears have been paid
- Obtain separate employment contracts (make sure to include termination provisions)
- Company portion for current service costs and pension benefits made prior to crystallization

Priority Creditors – Cont.

Utilities

- No priority however, may require arrears to be paid for continued service or deposit equal to arrears
- Bankruptcy of debtor eliminates any arrears issues, security deposit may still be required

Property Taxes

- Ability to sell real property if 3 years of property taxes have not been paid
- Ranks in priority to claims of secured creditors

Workers Compensation

- No priority unless registered and only from date of registration
- May require clearance certificate

Assets of Third Parties

- Not assets of debtor and as a result, Receiver has no interest, unless can be sold for amounts in excess of purchase price (i.e.. sold for profit)

Environmental Issues

- Section 14.06(2) to (8) addresses liability for environmental damage problems prior to appointment of Receiver or which continued after appointment that were not the result of the Receiver's actions, gross negligence or willful misconduct
- Receiver must make a disclosure to Federal and Provincial authorities
- Prior to taking possession a review should be taken of the debtor's business for prospective environmental issues and costs
- A secured creditor may be held liable for the cleanup costs if taking over a property
- The Receiver should determine costs of clean up and whether it is beneficial to continue the action since it will be difficult to dispose of asset
- Depending on the risk, the secured creditor should consider the hiring of an environmental consultant to assess the potential liabilities

Environmental Issues – Cont.

If an order to remedy an environmental condition is made, the Receiver has 4 options:

- Comply with the order in the time limit specified
- Contest the order
- Abandon the property or dispose of it, if possible
- Request a stay in order to assess the effect of the Order and the viability of completing to the realizable value of the asset

Other Issues:

- Environmental issues continue to reduce the Receiver's ability to dispose of real property
- Watch for liens put on property for cleanup costs which will have priority over existing charges
- Make sure indemnity letter covers environmental issues
- Look for Standstill Agreements with Federal and Provincial environmental agencies

Environmental Issues – Cont.

Issues to consider

- Review nature of debtor's business for handling, storage and discharge of hazardous materials
- Review of manufacturing process and determine the type of chemicals used and the byproducts created
- Consider any visible environmental problems such as storage tanks, drums of oil, other chemicals on site and signs of leakage
- Identify previous occupants or owners of the premises and the nature of their business
- Determine if the debtor is subject to any administrative orders such as waste removal and clean up

Interim Receiver

The role of interim receiver has changed to the interim protection of assets:

- Period of appointment is restricted to 30 days for receiver (max)
- Powers of courts have been removed, now only take possession and control assets. Courts to provide direction on what constitutes control.
- Can dispose of perishable property and take conservatory measures
- Proposal time line extends to court approval or when assets are in possession of trustee (failed proposal or bankruptcy)
- Cannot unduly interfere with debtor in carrying on of business unless it is necessary to conserve and comply with court order

Interim Receiver – Cont.

Consider:

- The type of business i.e. – cash transactions
- Economy of appointment
- Sufficient assets, free assets
- Added costs
- Previous conduct of debtor
- Will debtor defend
- Chance of insolvency – strong
- Appointment ends when a receiver or trustee take possession, or 30 days after appointment

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