TORYS

CAIRP NIQP Presentation Materials / Case Studies

TOPIC: OTHER INSOLVENCY ENGAGEMENTS

Handout #1 - Primary Materials:

- Background
- Case Study #1 (Questions and Answer Guide)
- Case Study #2 (Questions Only)

David B. Bish

Wednesday, September 12, 2018

1:00 p.m. - 5:00 p.m.

Doc. No. 25902678

Contents

TORYS

Agenda

TORYS

- Introduction
- Overview of Topics
- Analytical Insolvency Framework
- Case Study #1
    - *Bank Act*
    - US Bankruptcy Code
    - Cross Border Insolvencies
    - Securities Firm Insolvency
    - Section 147 BIA / Directive No. 10R
    - *Winding-up and Restructuring Act*
- Case Study #2

Overview of Topics to be Covered in this Session

TORYS

- *Bank Act*
- Cross-Border Insolvencies
- Directive 10R
- Ethics
- Informal Appointments - Monitoring / Look-see / Consulting / IBR's
- Informal Arrangements with Creditors
- Secured Creditor Appointments
- Risk Assessment
- Securities Firm Bankruptcy
- U.S. Bankruptcy Code
- *Winding-up and Restructuring Act* (WURA)

Analytical Insolvency Framework

TORYS

In order to better understand the miscellaneous topics to be covered in this session, it is important to understand their context within the larger practice of insolvency and restructuring work generally.

1. Insolvency Practice generally consists of one of only four (4) scenarios

The four (4) general insolvency scenarios are:

a) Informal engagements such as monitoring / look-see / consulting / independent business reviews (IBR's) may precede the traditional insolvency scenarios below (i.e. they are undertaken to determine what, if anything, is wrong, the scope of the problem and how to fix it, including whether an insolvency scenario is inevitable or recommended). An informal engagement will often lead to a further process in one of the three scenarios below.

b) Hard Stop - Bankruptcy / Liquidation (Debtor and Creditor-Focused Scenario)

   a. Bankruptcy, Consumer (BIA)
   b. Bankruptcy, Corporate (BIA)
   c. *Winding-up and Restructuring Act* (WURA)
   d. CCAA (rare for liquidation – but has been done; e.g. Target Canada)

c) Soft Landing - Restructuring (Debtor-Focused Scenario)

   a. Proposal, Consumer (NOI v. filing)
   b. Proposal, Corporate (NOI v. filing)
   c. *Companies' Creditors Arrangement Act* (CCAA) (restructuring focus)
   d. OBCA / CBCA Plan of Reorganization (though technically more suited to solvent companies)
   e. Informal restructuring

Analytical Insolvency Framework…cont'd

TORYS

d) Orderly Realization / Exercise of Remedies (Creditor-Focused Scenario)

a. Unsecured creditor remedies (e.g. statement of claim; garnishment; collection agency; distraint; repossession; etc.)

b. Receivership (whether interim receiver / receiver / receiver and manager, and whether privately or court appointed)

c. *Companies' Creditors Arrangement Act* (CCAA) (realization focus)

d. Direct Enforcement by Secured Creditor

i. Demand Letter / BIA "Section 244 Notice"

ii. Enforcement re: Personal Property (e.g. PPSA (Ontario) — foreclosure v. power of sale)

iii. Enforcement re: Real Property (i.e. *Mortgages Act* (Ontario) — foreclosure v. power of sale v. judicial sale under *Rules of Civil Procedure* (Ontario))

Analytical Insolvency Framework…cont'd

TORYS

2. **There are only a few ways to commence these four (4) insolvency scenarios — the paths to insolvency are limited**

   I. **BANKRUPTCY / LIQUIDATION**

   Bankruptcy may occur in four (4) scenarios:

   1. Voluntary Assignment filed by the debtor
   2. Application for a Bankruptcy Order declaring the debtor to be bankrupt on the application of one or more creditors
   3. Unsuccessful Proposal (i.e. Proposal not made within six months or rejected by unsecured creditors or upon refusal of the Court to approve a Proposal under Part III of the BIA)
   4. Proposal annulled by the Court

   II. **RESTRUCTURING**

   A restructuring of debt may be achieved by two (2) means:

   1. Plan of Compromise or Arrangement (CCAA)
   2. Proposal (BIA)

   For a restructuring of equity (and, in some cases, debt being converted to equity – usually bond debt):

   - Restructuring under corporate statutes (e.g. OBCA / CBCA Plan of Arrangement), either in isolation or in combination with one of the foregoing

Analytical Insolvency Framework…cont'd

TORYS

III. **RECEIVERSHIPS**

Receivers or receiver / managers may be appointed in two (2) scenarios:

1. Private appointment, pursuant to contract (and subject to applicable law, such as PPSA); or
2. Court appointment, pursuant to:
    a) Provincial rules of civil procedure, such as Rule 60.02 of the Rules of Civil Procedure (Ontario) in respect of enforcing Orders for payment or recovery of money;
    b) Provincial statutes, such as Section 101 of the *Courts of Justice Act* (Ontario) in conjunction with Rule 41 of the Rules of Civil Procedure (Ontario);
    c) BIA (receiver or interim receiver); or
    d) Any other statute that provides for or authorizes the appointment of a receiver or receiver manager (e.g. receiver under *Securities Act* (Ontario)).

Interim Receivers may be appointed in four (4) instances:

1. On or after the filing of a bankruptcy application (BIA s. 46);
2. On the filing of a Notice of Intention to File a Proposal or the filing of a Proposal under Part III of the BIA (BIA s. 47.1(1));
3. When an enforcement notice is about to be sent or has been sent by a secured creditor indicating its intention to enforce its security (BIA s. 47(1)); or
4. Possibly in combination with other proceedings (e.g. CCAA restructuring). The 2009 amendments to the BIA may make it less likely that an interim receiver would be sought in the context of other proceedings (and more likely to seek full receiver under BIA).

Analytical Insolvency Framework…cont'd

TORYS

A "full-blown" receiver may be appointed under BIA s. 243.

The 2009 amendments to the BIA altered receivership proceedings:

- Interim receiverships are restricted and intended to be truly "interim" — the duration of appointments are limited and the powers of an interim receiver are curtailed.
- The broad powers of an interim receiver were previously imparted under the Court's jurisdiction to direct an interim receiver to take such actions as the Court considered advisable — this has been repealed and the list of possible powers of the interim receiver is finite and limited.
- The "national" receiver under BIA s. 243 appointments is restricted to cases on "applications by a secured creditor" — prior practice of debtor putting itself into receivership (often as part of a pre-packaged sale transaction) is curtailed.
- The Court has discretion where it "considers it appropriate" under BIA s. 243(1.1) to appoint a receiver even where the 10 day notice period under BIA s. 244(1) has not run.
- A receivership application is to be filed "in a court having jurisdiction in the judicial district of the locality of the debtor". This appears to address only which province to file in, not which municipality within a province.

Analytical Insolvency Framework…cont'd

TORYS

3. **Within these four (4) insolvency scenarios, there are a limited number of roles for Licensed Insolvency Practitioners:**
    1. Trustee in bankruptcy (BIA)
    2. Proposal trustee (corporate) or Administrator (consumer) (BIA)
    3. Receiver / receiver and manager / interim receiver
    4. Monitor (CCAA)
    5. Information Officer (BIA or CCAA)
    6. Liquidator (WURA)
    7. Agent of secured creditor (e.g. collecting receivables or rents, under *Bank Act,* but note ethical / independence issues in audit situations)
    8. Informal monitor / consultant for monitoring / looksee / consulting / independent business reviews (IBR's), etc., though these roles would typically be played prior to one of the four principal insolvency scenarios unfolding

Analytical Insolvency Framework…cont'd

TORYS

Much of the time, the substance of your role remains the same regardless of the title given to your role (although the details, procedures, documentation to be filed with the Superintendent's Office, etc. change from role to role).

Key components of most roles include:

- Oversight / monitoring
- Reporting (though to whom you report may change — court v. secured creditor v. debtor, etc.) — often you control information
- Reviewing past transactions / events
- Assisting debtor (whether as its agent, or at behest of the court or stakeholders) — tasks such as: (i) assisting discussions with key stakeholders; (ii) preparing and analyzing financial statements / budgets; (iii) rationalization and review of business practices / organization, etc.; and (iv) assessing and resolving claims against the debtor. Bottom line — helping the debtor get a handle on what went wrong and how to fix it, while also typically co-ordinating / handling certain aspects of insolvency proceedings (esp. procedural / process)
- Preservation and sale / liquidation of assets

Case Study #1 — Questions and Answer Guide

TORYS

Usual Caveat: The facts described below are for illustrative purposes only. Due to the fact that this session is intended to canvass a diverse range of issues and subjects, some facts / questions may be somewhat incompatible or contradictory. This case study is intended only as a fictitious but practical exercise to provide context to the subject matter.

THE FACTS

- Your firm (and you specifically) have been approached by a large U.S. asset-based lender (ABL) that has recently been operating in Canada. The ABL has not worked with you or your firm previously, but is exploring potential new business relationships and has informed you that future work may be directed to you and your firm should the present matter go well.
- The ABL indicates that it has an existing debtor in respect of which it has become concerned. The debtor's business / operations / assets are located principally in Canada, but also in the United States.
- The ABL is fully secured under a standard-form General Security Agreement (GSA), providing for a security interest in all material real and personal property of the debtor (which GSA has been registered under the applicable provincial PPSA's). There are no other security documents aside from the GSA.
- Several senior representatives of the ABL have asked to meet with you to discuss this troubled loan.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

Upon meeting with the ABL, the ABL indicates that the debtor is very co-operative at present. Although the ABL does not believe that enforcement is required at this point, it would like to take the opportunity to ensure that it is well-positioned should the debtor's position worsen. Among other things, the ABL expresses to you a concern that they might benefit or be better protected by taking *Bank Act* security (which they do not presently have, having instead only the GSA). They inquire as to your views as to whether they ought to take *Bank Act* security.

QUESTION #1 RE: *BANK ACT*

1. Should ABL take *Bank Act* security and what benefits, if any, does it afford over and above the ABL's existing security? Explain to ABL how it would take such security.

ANSWER:

Bank Act

Statute: *Bank Act,* S.C. 1991, c. 46.

A. Focus of Statute:

- Relevant sections re: granting of security interests are principally Sections 427 and 428 (and 426 for security over hydrocarbons and minerals).
- Purpose of Section 427 and related sections of the BA is to enable farmers and other primary producers, as well as manufacturers, to finance their operations by bank loans secured by pledging existing goods and goods that are not then in existence, but which they expect to produce in the future (i.e. thereby encouraging the development of natural resource and manufacturing industries).

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- The BA is limited in scope – only certain lenders, certain borrowers and certain collateral:
  - Section 427 of the BA provides for a unique form of security available only to "banks" (i.e. defined to be Schedule I and Schedule II banks (i.e. Canadian chartered banks and foreign bank subsidiaries incorporated under the *Bank Act*)). The Business Development Bank of Canada (BDBC) may also take such security. Other lenders (such as foreign bank branches, credit unions, trust companies, caisses populaires, treasury branches) cannot take BA security
    - Schedule I banks are domestic banks and are authorized under the *Bank Act* to accept deposits, which may be eligible for deposit insurance provided by the Canadian Deposit Insurance Corporation (CDIC) (e.g. BMO, CIBC, NBC, RBC, TD, BNS, etc.)
    - Schedule II banks are foreign bank subsidiaries authorized under the *Bank Act* to accept deposits, which may be eligible for deposit insurance provided by the CDIC. Foreign bank subsidiaries are controlled by eligible foreign institutions (e.g. Amex Bank, BofA Canada Bank, HSBC Bank, UBS Bank, Walmart Canada, etc.)
    - Schedule III banks are foreign bank branches of foreign institutions that have been authorized under the *Bank Act* to do certain banking business in Canada. These branches have certain restrictions, including not accepting deposits (e.g. Bank of America, Barclays, Capital One Bank, Comerica Bank, Credit Suisse, Deutsche Bank, PNC, Wells Fargo, etc.)

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Such security can only be taken with respect to loans by banks to certain kinds of borrowers and only with respect to certain assets of the borrower, principally:
  1) Wholesale or retail purchasers, shippers or dealers in products of agriculture, products of aquaculture, products of the forest, products of the quarry and mine, products of the sea, lakes and river or goods, wares and merchandise on the security of such products or goods (s. 427(1)(a));
  2) Manufacturers on the security of the goods produced or goods procured for the production or packing of the manufactured goods (s. 427(1)(b));
  3) Farmers on the security of crops, agricultural equipment, agricultural implements (ss. 427(1)(d),(f),(j),(l) and (n));
  4) Farmers or other persons engaged in livestock raising on the security of feed or livestock (s. 427(1)(h));
  5) Fishermen on the security of fishing vessels, fishing equipment or products of the sea (s. 427(1)(o));
  6) Forestry producers on the security of fertilizer, pesticide, forestry equipment, forestry implements or products of the forest (s. 427(1)(p)); and
  7) Aquaculturists on the security of aquaculture stock, aquacultural equipment or aquacultural implements (ss. 427(1)(c),(e),(g),(i),(k) and (m)).

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- BA security therefore cannot be taken against consumer borrowers.
- BA security may only be taken against borrowers, not guarantors.
- BA security may not be taken over equipment used in manufacturing (except packaging), accounts, intangibles, securities, motor vehicles or consumer goods.
- The original reason for the enactment of a federal secured transactions regime was that banks were prohibited from taking security rights in personal property or moveables to secure their loans (i.e. in the banks' charters). In order to promote the granting of credit to certain vital sectors of the economy, such as farming, fishing, forestry, and manufacturing, the BA provided that a special form of security could be given to a bank.
- In 1967, the banks were permitted to lend on the security of personal property other than pursuant to security under the BA. This generally coincided with the enactment of provincial PPSA legislation, resulting in banks increasingly relying on provincial security legislation rather than, or in conjunction with, the BA.

B. Nature of Bank Act Security

- Security taken pursuant to Section 427 of the BA is not in the nature of a floating charge; rather, it constitutes a fixed charge over all assets covered by the security and over subsequently acquired assets as soon as they are acquired.
- When Section 427 security is given by a borrower to a bank, legal title to the secured property passes to the bank. Possession, however, remains with the borrower, who has a licence to sell the property in the ordinary course of business. As such, the borrower can deal with the secured property in the ordinary course of business, giving good title to a purchaser and bringing under the security property that is subsequently acquired.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- The borrower retains an equity of redemption to reacquire the legal title to the secured property on discharge of the bank's debt.
- The transfer of title is a critical distinction between BA security and security taken under provincial PPSA regimes (which do not effect a transfer of title). One benefit of the transfer of title is that it appears to defeat subsequent statutory deemed trusts (which otherwise have priority over PPSA security interests); it also defeats certain landlord rights and remedies (e.g. distraint).
- Many of the BA security provisions are rarely encountered in a commercial context (i.e. those provisions dealing with loans to, and security from, farmers, fishermen, growers and producers of agricultural products, etc.).
- Once a bank has BA security, any guarantor of the debt who satisfies its guarantee obligation is subrogated to the bank (even though not a person who could have taken BA security at first instance). Similarly, a bank with BA security may assign it to any person, even if not a person who could have taken BA security at first instance (subsections 428(13) and (14)).

C. Acquiring Bank Act Security

- Taking security under the BA is very technical, and strict compliance with the rules is required.
- Security may be taken in presently-owned and after acquired property.
- Security will only be effective to secure an advance if the advance is made at the same time as the security is taken, or if the borrower gives to the bank at the time of the first advance its written promise or agreement to give Section 427 security to the bank (e.g. inventory financing under a revolving line of credit). Security may not be given for a pre-existing debt. The BA therefore does not permit subsequent perfection of the security by registration.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Key rules include:
  - there must be an eligible borrower under Section 427(1)
  - there must be eligible property under Section 427(1)
  - the procedures in Section 427(4) must be followed
- Typically, there are four documents associated with BA security:
  - Notice of Intention To Give Security
  - Credit Application and Promise to Give Security
  - Security Agreement
  - Loan Agreement
- Procedure:
  - To obtain security under Section 427, a bank must register at the Bank of Canada a Notice of Intention signed by the borrower. The notice must be registered in the three (3) year period immediately preceding the giving of the security (s. 427(4)(a)). It is registered in the office of the agent of the Bank of Canada in the province or territory where the borrower has its principal place of business or residence (s. 427(5)). The form of the notice is set out in Schedule III to SOR/92-301, as amended.
  - With respect to some security (i.e. involving interests in land), the bank must also register its interest against the land at the proper land titles office by filing the security assignment or a caveat.
  - If a Notice of Intention is not registered, the security is void as against creditors and as against subsequent purchasers and mortgagees in good faith (s. 427(4)(a)). Since, as a result of failing to register a notice of intention, such security is void rather than voidable, it is unnecessary for a creditor to take steps to have the security declared void (i.e. it's automatic).

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Procedure (Con't):
  - A Notice of Intention is valid for five (5) years (s. 6 of SOR/92-301, as amended) and must be kept registered even after the giving of the security. A bank is required annually during the month of March to send to the appropriate agency of the Bank of Canada, a statement listing every Notice of Intention that was registered more than five (5) years before the end of the preceding December in which Section 427 security is still in effect. The registration of the notice is extended for one (1) year. Any Notice of Intention that has been in force for five (5) years and that is not included on the statement is cancelled by the agent (s. 7 of SOR/93-301, as amended).
  - The Notice of Intention must be registered prior to the security being given to the bank; subsequent registration is ineffective. Once registration has occurred, the bank may enter into a security document or assignment. The security documents must be fully completed, executed and delivered to the bank prior to the bank advancing funds to the borrower. The security documents are not registered.
  - An Application for Credit and Promise to Give Security may be obtained by the bank at any time (even prior to the registration of the Notice of Intention). In practice, it is executed together with the loan agreement and the security agreement / assignment.
  - Thereafter, funds may be advanced to the borrower.
  - A Certificate of Release may be registered at the Bank of Canada, which permanently cancels the Notice of Intention. Alternatively, the Notice of Intention may be left to expire.
  - Security under Section 427 is actually given to a bank by means of an assignment, which must be in a prescribed form (Schedule II of SOR/92-301, as amended).
  - The relevant time for determining a bank's rights under the BA are as at the time it acquires its security interest pursuant to the assignment, not the time of the registration of the notice of intention (i.e. it is the assignment that causes the bank's security interest to attach to the assets in question). As such, registration of the notice of intention does not confer priority on the bank; it simply protects the bank from subordination to creditors and subsequent purchasers or mortgagees.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Procedure (Cont'd):
  - To cancel or release Section 427 security, a bank must register a certificate of release with the agent of the Bank of Canada where the notice of intention was filed (s. 427(4)(b) and s. 4 of SOR/92-301, as amended).

D. Priorities Under the Bank Act:

- Section 427(2)(d) vests in a bank a first and preferential lien and claim upon the property that is the subject of the security and the same rights and powers in respect of the property as if the bank had acquired a warehouse receipt or bill of lading (i.e. the rights and powers of an owner).
- Subsection 428(1) states that all the rights and powers of a bank in respect of property covered by security under Section 427 have priority over all rights subsequently acquired in respect of such property, and also over the claim of any unpaid vendor.
- Subsection 428(2) states that the priority under subsection 428(1) does not extend over the claim of any unpaid vendor who had a lien on the property at the time the bank acquired the security, unless at the time the bank acquired the security, the bank was not aware of the lien's existence.
- There are a few exceptions to the priority enjoyed by a bank under the BA (i.e. pertaining to employees' claims for wages, claims for growers and producers of agricultural products and good faith purchasers without notice in the ordinary course of the borrower's business).
- Generally, as between BA and PPSA security, first to register/perfect has priority. However, PMSIs are unclear (including paramountcy issue) and where there is a title reservation clause, PPSA appears to have priority.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

E. Enforcement of Bank Act Security

- Enforcement of BA security is a federal matter. If a Notice of Intention is registered prior to any other interest under provincial law, provincial law will have no application to the enforcement process (e.g. PPSA notice requirements, provincial limitation periods, provincial exemptions from execution, etc.).
- Typically, the majority of bank loans involving BA security are demand loans. Enforcement typically commences with a demand for payment. There is some uncertainty in any particular case as to what amount of notice must be given before further enforcement steps may be taken – the common law requires that a reasonable period of time following demand to make payment be granted (but this will vary from case to case, and there are no hard and fast rules).
- Enforcement is only permitted in limited cases under Section 427(3); namely:
  - non-payment of loans;
  - failure to care for the property in question;
  - attempts to dispose of the property without the consent of the bank; or
  - seizure of the property.
- A bank may exercise contractual rights in its loan and security documents, including the appointment of a private receiver. Unlike many private appointments (i.e. where the receiver so appointed is contractually agreed to be the agent of the debtor, not the lender), a receiver appointed by a bank in respect of bank security is always the agent of the bank, not the lender. This is because the bank is the *de facto* owner of the property by operation of the BA.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- If a loan for which the security is given is not paid, a bank may take possession of, or seize, the property and sell it and apply the proceeds against the amount outstanding on the loan. A bank is authorized to enter upon land and premises in order to seize the property in question and to remove fixtures covered by its security (Section 427(3)).
- Even if security is invalid under the BA, it might still be valid under the PPSA (e.g. a bank can perfect its security interest under the PPSA by taking possession of the collateral, even though the bank has failed to comply with the registration provisions of the BA).
- A bank holding Section 427 security only gets the right and title to the property that the owner of the property has. Therefore, where a bank obtains security on a property acquired by the debtor under a conditional sales contract, the bank only gets priority over the claim of the conditional vendor to the extent of the right and title of its customer, the debtor, which is no more than a right of possession until the purchase price is paid. The bank only has a right to any surplus to which the debtor would be entitled after satisfaction of the conditional vendor's claim.
- Section 428(8) requires that assets covered by Section 427 security be sold by public auction. However, the person that has given the security may agree to a sale in some other mode. If the debtor co-operates with and assists the bank's agent in the realization of its security, it is deemed to have made such an agreement.
- Sections 428(10) and (11) impose the duty on a bank and on any agent employed by it to act honestly, expeditiously and in good faith in selling a property that is the subject of Section 427 security. A bank is not under a duty, however, to obtain the "true market value" for the goods seized. A bank is required to avoid any practice that would obviously deflate bids and must ensure that the debtor receives the maximum benefit from the disposal of his or her assets consistent with a forced auction sale. Special disposal rules exist for perishable property.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

The ABL's senior loan officers in Canada confess to having little prior history involving U.S. or cross-border insolvencies, but they believe that some kind of insolvency proceedings would be required in the U.S. given that the debtor does have material assets / operations there. They ask if you are familiar with the U.S. insolvency regime, and what proceedings would be appropriate.

QUESTION #2 RE: U.S. BANKRUPTCY CODE

1. Explain for the ABL how, generally, insolvency proceedings work in the U.S., the applicable legislative framework, and the key provisions of that legislative framework.

ANSWER:

U.S. Bankruptcy Code

- In the U.S., all forms of insolvency – including restructuring – are referred to as "bankruptcy"
- Bankruptcy law is federal statutory law contained in Title 11 of the United States Code. Congress passed the Bankruptcy Code under its Constitutional grant of authority to ''establish ... uniform laws on the subject of Bankruptcy throughout the United States." *See* U.S. Constitution Article I, Section 8. States may not regulate bankruptcy though they may pass laws that govern other aspects of the debtor-creditor relationship. A number of sections of Title 11 incorporate the debtor-creditor law of the individual states.
- Bankruptcy proceedings are supervised by and litigated in the United States Bankruptcy Courts. These courts are part of the federal District Courts of the United States. The United States Trustees were established by Congress to handle many of the supervisory and administrative duties of bankruptcy proceedings. Proceedings in bankruptcy courts are governed by the Bankruptcy Rules that were promulgated by the Supreme Court under the authority of Congress.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- There are four (4) principal types of bankruptcy in the U.S.:

1. Chapter 7

- Chapter 7 bankruptcy is a liquidation proceeding available to consumers and businesses. Those assets of a debtor that are not exempt from creditors are collected and liquidated (reduced to money), and the proceeds are distributed to creditors. A consumer debtor receives a complete discharge from debt under Chapter 7, except for certain debts that are prohibited from discharge by the Bankruptcy Code.

2. Chapter 11

- Chapter 11 bankruptcy provides a procedure by which an individual or a business can reorganize its debts while continuing to operate. The vast majority of Chapter 11 cases are filed by businesses. The debtor, often with participation from creditors, creates a plan of reorganization under which to repay part or all of its debts.

3. Chapter 12

- Chapter 12 allows a family farmer to file for bankruptcy, reorganize the farm's business affairs, repay all or part of the farm's debts, and continue operating.

4. Chapter 13

- Chapter 13, often called wage-earner bankruptcy, is used primarily by individual consumers to reorganize their financial affairs under a repayment plan that must be completed within three or five years. To be eligible for Chapter 13 relief, a consumer must have regular income and may not have more than a certain amount of debt, as set forth in the Bankruptcy Code.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Under Chapter 7, 12, 13, and some 11 proceedings, a trustee is appointed to supervise the assets of the debtor. A bankruptcy proceeding can either be entered into voluntarily by a debtor or initiated by creditors. After a bankruptcy proceeding is filed, creditors, for the most part, may not seek to collect their debts outside of the proceeding. The debtor is not allowed to transfer property that has been declared part of the estate subject to proceedings. Furthermore, certain pre-proceeding transfers of property, secured interests, and liens may be delayed or invalidated. Various provisions of the Bankruptcy Code also establish the priority of creditors' interests.
- *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* brought major changes to U.S. bankruptcy law. Of key interest for Canadians was the enactment of Chapter 15, which replaced Section 304 applications. Chapter 15 of the Bankruptcy Code became law on April 20, 2005. Chapter 15 deals with the recognition of foreign bankruptcy or insolvency proceedings and is based on the Model Law on Cross Border Insolvency prepared by the United Nations Commission on International Trade Law (UNCITRAL).
- Very roughly speaking:

  Chapter 7 = BIA bankruptcy / liquidation
  Chapter 11 = CCAA restructuring
  Chapter 15 = CCAA Part IV / BIA Part XIII (recognition of foreign insolvency proceedings)

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

2. Explain for the ABL how the bankruptcy regimes in Canada and the U.S. compare.

- U.S. proceedings often achieve comparable substantive outcomes when compared to equivalent Canadian proceedings. Canadian bankruptcy law is heavily influenced by English law, but in recent decades has steadily been influenced by U.S. law / development (i.e. some convergence, with Canada often trailing U.S. developments)
- However, U.S. proceedings are typically much more expensive, time-consuming and paper-intensive.
- Whereas Canadian insolvency law leaves much to the courts and practice to be determined (more flexible but less predictable), the U.S. approach is to have extensive codification in statute (less flexible but more certainty).
- Canadian court officer roles (e.g. Monitor, Proposal Trustee) are not replicated in the U.S. A U.S. bankruptcy trustee is very different than a trustee in bankruptcy in terms of roles and powers – it is part of the U.S. Department of Justice and is responsible for overseeing the administration of bankruptcy estates. It is more akin to the Canadian Superintendent of Bankruptcy / Official Receiver role than it is to a trustee in bankruptcy.
- The U.S. has many more insolvencies than we do in Canada. As a result, there is vastly more case law in the U.S. (i.e. in Canada, it is not uncommon to find little case law on a particular issue, whereas in the U.S. you can almost always find cases, often conflicting)
- The U.S. system has features Canada does not, such as unsecured creditors committees (UCC) and doctrines / practices not found in Canada, such as: (i) secured creditors' rights to adequate protection; (ii) craw-downs; (iii) equitable subordination; (iv) much more extensive provisions re: avoidance actions; (v) the creation of a new legal estate upon bankruptcy; and (vi) more developed D&O liabilities concepts, such as "deepening insolvency".

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

The ABL asks how it should proceed in both Canada and the U.S. and requests a description of the events and timeframes that would characterize cross-border proceedings.

QUESTION #3 RE: CROSS-BORDER INSOLVENCY PROCEEDINGS

1. Explain for the ABL what alternative cross-border proceedings are available in Canada and the U.S., and the key considerations in determining which type of proceeding to commence in Canada and the U.S. (i.e. whether restructuring or liquidation, whether CCAA or BIA, whether Chapter 7, 11 or Chapter 15). How are separate proceedings in Canada and the U.S. co-ordinated?

ANSWER:

Cross Border Insolvencies

A. Three principal questions to address:

1) which country's courts are competent to deal with a specific matter?
2) which country's laws should apply to a particular issue?
3) whether a judgment or decision by a judicial authority in one country will be recognized and enforceable in another country?

B. Two* Simple *Categories of Proceedings:

1) Plenary
2) Ancillary

This gives rise to three scenarios: (a) plenary in both jurisdictions (whether joint vs. concurrent proceedings); (b) plenary in domestic / ancillary in foreign; (c) ancillary in domestic / plenary in foreign.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

C. Two Forms of Ancillary Proceedings in Canada

1. Part XIII of the BIA

   - Part XIII of the BIA was enacted as part of the amendments to the BIA in 1997 and provided codification and clarification of the domestic rules applicable to international insolvencies in order to promote greater co-operation and co-ordination with other jurisdictions. Part XIII of the BIA was significantly amended by the changes that came into effect in 2009.
   - The changes were intended to mirror the UNCITRAL Model Law, though significant distinctions exist.
   - There are two prerequisites to the commencement of an application to recognize foreign proceedings. First, such an application may only be made by a "foreign representative" and second there must be a "foreign proceeding", each as defined in the BIA.
   - The court in making an order under Part XIII may make such order conditional on compliance by the foreign representative with any other order of the court (Section 280).
   - In recognizing a foreign proceeding, the court is required to specify whether the foreign proceeding is a foreign main proceeding or a foreign non-main proceeding, which is an important distinction given the resulting powers, remedies and relief that flow from this determination.
   - Generally, where foreign proceedings are found to be foreign main proceedings, the foreign representative is entitled to much broader relief and the Canadian court has less discretion than is the case for foreign proceedings that are determined to be foreign non-main proceedings.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- A foreign main proceeding is defined to be a foreign proceeding in a jurisdiction where the debtor has its centre of main interests (COMI). A foreign non-main proceeding is any other foreign proceeding, other than a foreign main proceeding. The determination of COMI is typically the most important aspect of an application to recognize foreign proceedings.

2. Part IV of the CCAA
   - Cross-border insolvency provisions were previously set out in Section 18.6 of the CCAA, but were significantly overhauled in the 2009 amendments.
   - Previously, provisions similar to Part XIII of the BIA were enacted as part of the amendments to the CCAA in 1997 (i.e. Section 18.6). However, consistent with the general approach by Parliament to each of the BIA and the CCAA, the provisions contained in Part XIII of the BIA were more fulsome than Section 18.6.
   - With the 2009 amendments, the BIA and CCAA's cross-border provisions are now much more similar (though there are some differences between the provisions in the BIA and those in the CCAA re: cross-border insolvencies).
   - The crux of an application remains as under the BIA — the existence of a foreign representative and one or more foreign proceedings, and a determination based on COMI as to whether the foreign proceedings are main or non-main.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

2. How are separate proceedings in Canada and the U.S. co-ordinated?

ANSWER:

Cross-Border Protocols

A common manner of addressing these issues is the use of a cross-border protocol to establish the procedures and processes pursuant to which:

a) jurisdictional issues are to be resolved;

b) communications between the respective courts are to occur;

c) information is be presented to the respective courts; and

d) creditors' claims (including proof and voting of such claims and barring of claims) are to be handled.

While there is no standard form in which a protocol must be prepared, it will typically contain the following elements:

a) *Introduction:* A protocol will typically commence with an overview of the intended purpose and scope of the protocol.

b) *Background:* It is customary for *a* protocol to provide a factual overview of the insolvent entities. This background information will not focus on the financial and business history of the insolvent companies, but will instead provide a detailed explanation of the legal entities involved, the relationships between the insolvent entities and their connection with the jurisdictions in question. The intention behind these provisions is to demonstrate to the courts the inter-connectedness of the companies and the jurisdictions in question in order to convince the courts that a coordinated cross-border response to the insolvencies is warranted.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

c) *Purpose and Goals:* The protocol will then delineate in a broad, sweeping fashion the objectives that the protocol is to meet. These provisions typically contain grandiose "motherhood and apple pie" statements and assertions and will emphasize concepts such as "due process", "comity", "efficiency", "co-ordination", "harmonization", "integrity", "fairness", "openness", "reduced costs" and "avoidance of duplication". It is typical to stress in these provisions that the protocol will not, and is not designed to, divest or diminish the independent jurisdiction of the respective courts.

d) *Overview of Cross-Border Issues:* After having emphasized in broad terms the benefits that will result from the adoption and approval of the protocol, it is customary to focus on the specific cross-border issues that are anticipated to arise and the proposed manner in which such issues shall be addressed. Issues that may prospectively be discussed include:

- sale approvals;
- debtor-in-possession financing;
- Charges and interests which are to be granted and/or given a priority-status;
- the allocation of sale proceeds as between Canadian and U.S. entities or creditors;
- the allowance, priority and valuation of inter-company claims;
- the determination, priority and resolution of creditors' claims, including in respect of owned or leased personal property and including inter-company guarantee claims; and
- the approval and implementation of a restructuring plan.

It is important to note that the foregoing issues are not actually advocated or determined in the protocol; rather, the protocol merely establishes a substantive and procedural framework within which issues such as those mentioned above will ultimately be determined.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

e) *Framework:* Having delineated a non-exhaustive list of issues, a protocol will then proceed to set out a substantive and procedural framework for the proceedings in question. This framework may address such areas as:

- the conduct of joint court hearings;
- areas of exclusive jurisdiction;
- the manner in which the respective courts are to co-operate and corresponding procedural controls;
- the co-ordination of activities as between courts;
- the manner in which communications between the courts are to occur;
- requirements and procedures in respect of service and the giving of notice to interested parties, and an affirmation of the right of interested parties to appear and be heard in the courts of either or both jurisdictions, as appropriate;
- the retention and compensation of professional advisors / legal counsel;
- recognition of stays of proceedings; and
- a re-affirmation of the independence of the respective courts.

All of the foregoing are designed to ensure openness, efficiency and fairness to participants in each country (including rights of access to the courts) — in short, the purpose and goals set out earlier in the protocol.

f) *Dispute Resolution:* It is not uncommon for protocols to provide a mechanism for the resolution of disputes that may arise in respect of the protocol itself.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

g) *Boilerplate*: A protocol will typically end with certain "boilerplate" paragraphs concerning such things as the date upon which the protocol becomes effective (i.e. the date upon which the protocol is approved by both Canadian and U.S. courts), restrictions on supplementing, modifying, terminating or amending the protocol, and the preservation of all interested parties' rights at law or in equity notwithstanding the terms of the protocol.

- In addition, in 2000 the American Law Institute (ALI) approved its "Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases", which were adopted by the International Insolvency Institute and the Insolvency Institute of Canada soon thereafter. These Guidelines provide for rules of cooperation and coordination between courts and have been extensively adopted in cases in North America (Canada / U.S. / Mexico) and abroad. They do not alter the substantive or procedural rights and rules in any country, but rather encourage and facilitate cooperation in international cases while observing all applicable rules and procedures of the courts involved. It is customary to append them to, and to adopt them as part of, any cross-border protocol.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

The ABL informs you that the troubled debtor in question is a securities brokerage firm. They ask whether this matters and whether it raises any additional considerations that they ought to be mindful of in determining how to proceed, and in assessing their options.

QUESTION #4 RE: INSOLVENT SECURITIES FIRMS

1. Explain for the ABL the key considerations involving securities firms.

ANSWER:

Securities Firm Insolvency

The elements of the scheme governing securities firm insolvencies are contained in Part XII of the BIA (i.e. differences from a traditional bankruptcy) and include the following:

- In addition to ordinary creditors, an application for a bankruptcy order against the securities firm may be filed by a securities commission, a securities exchange, a customer compensation body (i.e. CIPF) or a receiver. Standing is therefore given to various 3rd parties to initiate bankruptcy proceedings.
- The trustee has enhanced powers that can be exercised without permission of inspectors until they are appointed, in an effort to bring stability to the marketplace on a timely basis. Enhanced powers include the ability to sell securities, purchase securities, discharge security interests, complete open contractual commitments, maintain customer securities accounts and meet margin calls, distribute cash and securities to customers, transfer securities accounts to another securities firm, liquidate any securities accounts without notice, and sell, without tender, assets of the securities firm essential to the carrying on of its business. These enhanced powers reflect the reality that the compensation fund will be very active in the administration of the estate and requires the flexibility to enter into the marketplace to minimize customer exposure.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Securities owned by the securities firm and securities and cash received by or for the account of the securities firm or customers vest in the trustee.
- Two categories are established to divide securities held by the securities firm (subject to secured creditors rights):
  i. "customer name securities", which means securities which on the date of bankruptcy are held by or on behalf of the securities firm for the account of the customer or registered in the name of the customer. These securities are delivered to the customer;
  ii. a "customer pool fund" is established which includes securities or interest in securities held for customers other than "customer name securities". The customer pool fund is allocated, after certain administrative expenses, to customers, other than deferred customers, in proportion to their net equity with the balance going to the "general fund". Securities ordered but not delivered as directed at the time of the making of an assignment in bankruptcy vest in the trustee in bankruptcy as part of the customer pool fund and are used to pay costs of administration in accordance with s. 262(1)(a)
- Another category of assets, a "general fund", covers all the remaining property vested in the trustee. Property in the "general fund" is used to pay first the costs of administration and then is distributed rateably:
  i. to deficiency claims of customers after the distribution of the "customer pool fund";
  ii. to the customer compensation body, to the extent that it has paid or compensated customers in respect of their net equity;

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

iii. to ordinary creditors in proportion to the value of their claims; and

iv. creditors referred to in Section 137 of the Act (i.e. creditors privy to reviewable transactions, wage claims of spouses) are next in priority, with deferred customers being the last group that receives any distribution. A "deferred customer" means a customer whose misconduct caused or materially contributed to the insolvency of a securities firm.

- Because the scheme contemplates a very dominant role of a customer compensation body, there is a provision that, when customers are protected by such a compensation body, the trustee shall consult with the compensation body on the administration of the estate and an inspector can be designated by the compensation body.

The legislation reflects an attempt to administer securities firm insolvencies on a timely and cost effective basis while maintaining the mandate of the compensation body to protect customers up to the maximum limits.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

Following the meeting, the ABL retains you and you proceed to provide informal advisory / consulting / monitoring services to the ABL for several months with respect to this matter. The situation with the company worsens, but the ABL informs you that they are very impressed with your performance. You recommend a court-appointed receivership as the best means of proceeding, and your firm is subsequently appointed a Court-appointed receiver at the behest of the ABL. A senior partner at your firm congratulates you on a job well done and eagerly contemplates the likely future work from the ABL that your firm will receive. Three weeks later the ABL contacts you and informs you that they want you as receiver to "turn out the lights" and liquidate the assets (i.e. cease all operations). In your view, a liquidation would result in the payment in full of ABL's debt, but would leave little or nothing for other creditors.

QUESTION #5 RE: ETHICS / DUTIES

1. What ethical concerns does this scenario touch upon, and how do you respond to ABL's demands?

ANSWER:

- Insolvency practitioners need to navigate ethical obligations versus certain business realities (and avoid compromising the former because of the latter). This includes often having to take into consideration that decision-making is made under circumstances of urgency and imperfect information.
- Clearly, do not allow the prospect of future work (or loss of future work) to influence your decision making — this includes not being unduly influenced by the ABL or by the senior partner on the file.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Guard against conflicts of interest and beware of becoming too enamoured with the creditor that first involved you.
  - in many instances debtors elect the choice of insolvency practitioner (e.g. debtor-initiated insolvency proceedings such as restructurings under the CCAA or BIA) — insolvency practitioners are sometimes accused of being too close to the debtor / being an advocate for the debtor.
  - insolvency practitioners have established relationships with large financial players such as banks, ABL's, equipment financiers, venture capitalists, private equity players, bondholder groups, institutional investors, etc., and these "key creditor" groups often influence or make the decision as to which insolvency practitioner should be appointed on a given file — insolvency practitioners are sometimes accused of being too close to "key creditors".
- Some insolvency engagements offer the opportunity for, or otherwise lead to, subsequent insolvency engagements — this is especially true with respect to the possibility that informal engagements such as IBR's / informal monitoring / consulting / etc. may lead to formal insolvency scenarios such as restructurings or receiverships, as is the case in this example. Beware conflicts of interest — that is, unjustifiably steering a debtor, lender or other client to a scenario with a heightened or further role for your firm.
- Recognize (and explain to ABL) that although first retained in an informal engagement with the ABL as the client, the role of Court-appointed receiver makes you a fiduciary with duties to the Court, all creditors, and the debtor — you cannot take instructions or be directed by the ABL. ideally, this should have been discussed prior to the receivership appointment — managing client expectations in a timely manner can be key to avoiding unnecessary conflict or misunderstandings.
- Recognize that the ABL has the principal economic interest — its wishes should be given due weight (but not necessarily be determinative). Consider whether continuing operations exposes the ABL to material risk (i.e. of erosion of collateral, leading to a lesser recovery down the road).

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Consider what you believe to be in the best interests of the creditors generally (and consider other relevant stakeholder interests — employees, the debtor, shareholders, customers, suppliers, etc.). Keeping operations going may preserve value and provide a greater recovery to other creditors.
- Consider the practicalities of the situation — for example, who is funding operations? If it is ABL, there may be no opportunity to continue operations without the ABL's support (or else it may require finding another lender, who may expect priority ahead of ABL — this course of action, though possibly necessary, may escalate tensions with ABL).
- For contentious decisions, consider a motion / court approval (e.g. a motion for advice and directions). Also, consider timely disclosure to interested parties / the court (which is often an important defence / protection from subsequent claims).

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

Subsequently, the debtor becomes bankrupt and you are retained as trustee in bankruptcy. The ABL would like you to also act on their behalf to realize on their security.

QUESTION #6 RE: SECURED CREDITOR APPOINTMENTS

2. Given that you are the trustee in bankruptcy, are there any restrictions on your acting for / realizing on behalf of ABL?

ANSWER:

Section 147 BIA and Directive No. 10R

A. Superintendent's Levy:

- Section 147 of the BIA provides that, for the purpose of defraying the expenses of the office of the Superintendent of Bankruptcy, a levy is imposed on all payments made by the trustee by way of dividend or otherwise on account of the claims of creditors, whether unsecured, preferred or secured, including payments to the Crown in right of Canada or a province for taxes or otherwise.
- Section 136(c) of the BIA makes the levy a preferred claim, ranking subsequent only to funeral and testamentary expenses of a deceased bankrupt and the costs of the administration of the bankrupt estate.
- Exceptions: there is no levy payable:
    1) for any amounts payable pursuant to Section 70(2) of the BIA (i.e. the costs of the first execution creditor);
    2) for the distribution of trust funds;

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

3) for any distributions in respect of Section 136(a) or (b) (i.e. funeral / testamentary expenses and costs of administration); or

4) for certain distributions to secured creditors (discussed below).

- The levy is calculated on a lump sum based on the amount of the payments being made to creditors, but is charged proportionately against all payments and deducted before a payment is made to a particular creditor.
- Pursuant to Rule 123 of the BIA General Rules, the levy is as follows:

123. (1) Subject to subsections (2) and (3), the rate of levy payable on all payments, pursuant to Section 147 of the BIA, is:

(a) 5%, where the amount of payments is $1,000,000 or less;

(b) 5% of the first $1,000,000, plus 1¼% of the amount in excess of $1,000,000, where the amount of payments exceeds $1,000,000 but is not more than $2,000,000; or

(c) 5% of the first $1,000,000, 1¼% of the second $1,000,000, plus ¼% of the amount in excess of $2,000,000, where the amount of payments exceeds $2,000,000.

(2) The rate of levy payable in a *proposal is:*

(a) 5%, where the amount of payments is $1,000,000 or less;

(b) 5% of the first $1,000,000, plus 1¼% of the amount in excess of $1,000,000, where the amount of payments exceeds $1,000,000 but is not more than $2,000,000; or

(c) 5% of the first $1,000,000, 1¼% of the second $1,000,000, plus 0% of the amount in excess of $2,000,000, where the amount of payments exceeds $2,000,000.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

(3) The rate of levy payable for an *estate under summary administration* is:

(a) 100%, where the amount of payments is $200 or less; or

(b) 100% of the first $200 plus 0% of the amount in excess of $200, where the amount of payments exceeds $200.

B. Directive No. 10R:

- In an endeavour to clarify the payment of levy on secured claims (as there was some confusion on this point), the Superintendent of Bankruptcy issued Directive No. 10, "Redemption of Security and Section 147 Levy of the BIA", on December 19, 1997.
- Confusion persisted and a pivotal case in 2007 resulted in a decision in which Topolniski J. found that Directive No. 10 went beyond the authority of the Superintendent's powers in a number of respects insofar as it was not consistent with, and properly interpreted, the BIA *(Climenhaga* v. *Alberta (Office of the Superintendent of Bankruptcy)* (2008), 50 C.B.R. (5th) 218 (Alta Q.B.)).
- Accordingly, Directive No. 10 was replaced with effect as of May 22, 2009, by Directive No. 10R.
- The purpose of the Directive is to:
  1. specify the operation of Section 147 of the BIA in the case of the liquidation of encumbered assets on behalf of a secured creditor, with a subsequent payment of proceeds to the secured creditor;
  2. ensure greater transparency and uniformity in the trustee's presentation of the Statements of Receipts and Disbursements; and
  3. ensure that the body of creditors is not penalized in any way and does not bear any cost for the trustee's liquidation of encumbered assets on behalf of a secured creditor.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Under the Directive, levy is payable on all payments by a trustee to a secured creditor, even though the payment is made by a third party, such as an auctioneer, for and on behalf of the trustee, unless expressly excepted in Section 7 of the Directive.
- Exceptions: There are two exceptions where a levy is not payable (Section 7 of the Directive):
    1. If a trustee in selling assets is acting as agent for a secured creditor, or as a receiver or as a mandatory, in selling the encumbered assets, then no levy is payable
    2. The levy is also not payable if the trustee redeems security within the meaning in Section 128(3) of the BIA (in which case there are further requirements, discussed below)
- In the event that the trustee sells unencumbered and encumbered assets in the same transaction, the disbursements must be shared *pro rata* between these two categories of assets. If another method is used, the trustee must indicate the method used and justify the choice. Bottom line: the estate shouldn't get stuck bearing a disproportionate amount of the realization costs

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- Directive No. 10R provides that when proceeding with redemption of the security within the meaning of subsection 128(3) of the Act:
  - The trustee must assess the value of the security and amount of the debt before redeeming in full. The assessment shall be made by examining the proof of claim or proof of security submitted by the secured creditor. If the secured creditor does not produce a proof of claim, it is the trustee's responsibility to take advantage of the provisions of subsection 128(1) of the Act.
  - The trustee should only redeem the security if the net price realizable on the sale of the encumbered asset is equal to or greater than the debt or value of the security as per the proof of security or proof of claim (i.e. but no stated consequence — including payment of the levy — where this proves not to be the case).
  - Where the trustee has proceeded with redemption of a security within the meaning of Section 128(3) of the BIA, the trustee must file, with the Statement of Receipts and Disbursements, an Attestation in the form attached to the Directive.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

The ABL confides that the troubled loan is a very significant loan that comprises a significant portion of loan portfolio of the recently-formed Canadian arm of the ABL, so much so that the failure to recover this loan might impair the viability of the ABL. Out of an abundance of caution, the ABL wishes to better understand what an insolvency of the ABL might entail and asks if you are familiar with the *Winding-up and Restructuring Act* (WURA).

QUESTION #7 RE: WURA

1. Explain what the WURA is and how it operates.

ANSWER:

Winding-up and Restructuring Act

A. Application

- WURA contains the primary (but not exclusive) set of rules that govern the affairs of most regulated financial institutions experiencing financial distress (e.g. banks, trust companies, loan companies and insurance companies). Although the pith of the Act has, for the most part, been materially unaltered for many decades, there have been various nuanced reforms of the Act.
- The purpose of WURA is to provide for the orderly liquidation or, at least in theory, restructuring of a distressed financial institution. In practice, the restructuring provisions of WURA have all but been ignored; proceedings under WURA are almost uniformly liquidation proceedings. A liquidation is intended to be orderly, transparent and equitable, and to enhance the recoveries for stakeholders. The Act also serves broader underlying policy objectives; in particular, ensuring the stability of the Canadian financial system and markets.
- The Act only applies to corporations, not individuals.
- Most entities to which WURA applies are regulated entities that are regulated by the Office of the Superintendent of Financial Institutions (OSFI). OSFI is responsible for administrating the granting of charters for banks, trust companies, and loan companies. OSFI acts according to a number of federal statutes, most namely the *Bank Act* and the *Trust and Loan Companies Act*.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- The Act applies to all corporations incorporated by or under the authority of an act of Parliament, or the former province of Canada or of the province of Nova Scotia, New Brunswick, British Columbia, P.E.I. or Newfoundland, and whose incorporation and affairs are subject to the legislative authority of Parliament, and to incorporate banks and savings banks, to authorized foreign banks, and to trust companies, insurance companies, loan companies having borrowing powers, building societies having a capital stock and incorporated trading companies doing business in Canada wherever incorporated where such entity:
  - is insolvent;
  - is in liquidation or in the process of being wound up and, on petition by any of its shareholders or creditors, assignees or liquidators, asks to be brought under this Act; or
  - for financial institutions, is under the control of the Superintendent of Financial Institutions and is the subject of an application for a winding-up order under Section 10.1 (Section 6).
- The Act does not apply to building societies that do not have a capital stock or to railway or telegraph companies (Section 7).

B. Commencement of Proceedings

- A company may be wound up on any one of a number of grounds, one of which is insolvency (s. 10).
- WURA contains provisions that assist in the evidentiary determination as to when an entity subject to the Act is in distress. Section 3 of WURA sets out detailed circumstances in which a company is deemed to be insolvent and section 4 provides for the circumstances in which a company is deemed to be unable to pay its debts.
- The winding-up is deemed to commence at the time of service of notice of presentation of the petition for the winding-up (Section 5).
- Proceedings are initiated by way of petition filed with the Court. Depending on the grounds for the making of the winding-up order, the Act authorizes different parties, including the company, to make such application (Sections 10, 10.1, 11 and 12)

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

- A court is authorized by Section 10 to make a winding-up order in respect of a company, *inter alia*:
  - when the company is insolvent; or
  - when the court is of opinion that for any other reason it is just and equitable that the company should be wound up.
- As such, it is not strictly necessary that an entity be insolvent in order for the Act to be invoked (e.g. an entity that is in the vicinity of insolvency but not yet technically insolvent, as defined in the Act, could still be made subject to winding-up proceedings under the Act).
- Application is made by petition to the Court in the province where the head office of the company is situate or in the province where its chief place or one of its chief places of business in Canada is situate (Section 12).
- Except in cases where an application for a winding-up order is made by a company, four (4) days' notice of the application shall, unless otherwise directed by a court, be given to the company before the making of the application.
- A court may, on application for a winding-up order, make the order applied for, dismiss the application with or without costs, adjourn the hearing conditionally or unconditionally or make any interim or other order that it deems just.
- Often, OSFI takes "control" of a distressed financial services company (e.g. bank, trust company, insurance company) pursuant to its powers under statutes such as the *Bank Act* and the *Trust and Loan Companies Act*. This may be for only a moment in time, as OSFI typically coordinates with the Attorney General to make an application under WURA to commence winding-up proceedings (typically immediately or very soon after taking control). WURA does not give OSFI standing to make an application under WURA directly – only through the Attorney General.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

C. Jurisdiction of the Court

- The Act has some procedural provisions and also provides that the winding-up proceedings are to be carried on, as nearly as possible, as ordinary Court proceedings within the jurisdiction of the Court (Section 109).
- There are no specific rules promulgated under the Act.

D. Stay of Proceedings

- There is no automatic stay of proceedings provided for under WURA at the time that a petition for a winding-up order is made. However, a court may, on the application of a company, or of any creditor, contributory, liquidator or petitioner for the winding-up order, at any time after the presentation of a petition for the order and before making the order, restrain further proceedings in any action, suit or proceeding against the company, on such terms as the court thinks fit.
- Once a winding-up order is issued, there is a mandatory stay as set out in Section 21, which provides that after a winding-up order is made in respect of a company, no suit, action or other proceeding shall be proceeded with or commenced against the company, except with the leave of the court and subject to such terms as the court imposes. The Act is clear that the automatic stay does not affect the unwinding of eligible financial contracts. (Sections 17, 18 and 21).
- The company is not to carry on business after the winding up order is made (Section 19). The Act provides that a company, from the time of the making of a winding-up order, shall cease to carry on its business, except in so far as is, in the opinion of the liquidator, required for the beneficial winding-up thereof, but the corporate state and all the corporate powers of the company, notwithstanding that it is otherwise provided by the Act, charter or instrument of incorporation of the company, continue until the affairs of the company are wound up.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

E. Title to Assets

- From the time of the appointment, the liquidator takes control over the assets to which the company is or appears to be entitled. However, the assets do not vest in the liquidator (Section 33).

F. Liquidator

- It is mandatory under the Act that upon the granting of a winding-up order, the court shall appoint one or more liquidators of the estate and effects of the entity in question. The Court cannot appoint any person as liquidator who is not licensed as a trustee under the BIA, except CDIC (Section 23).
- A liquidator, on his appointment, shall take into his custody or under his control all the property, effects and choses in action to which the subject entity is or appears to be entitled, and shall perform such duties with reference to winding-up the business of the company as are imposed by the court or by this Act (Section 33).
- A liquidator shall, within 120 days after appointment, prepare a statement of the assets, debts and liabilities of the company and of the value of those assets as shown by the books and records of the company (Section 34).
- The liquidator is an officer of the Court. The exercise by the liquidator of its powers under the Act are subject to the approval of the Court (Section 35), and supplemental powers may be granted by court order.
- Upon the appointment of the liquidator, all powers of the directors cease, except to the extent sanctioned by the Court or the liquidator (Section 31).
- After a winding-up petition has been made but before the order is granted, the court may appoint a provisional liquidator (i.e. interim liquidator), and the court is authorized at Section 28 of the Act to limit and restrict his powers by the order appointing the provisional liquidator.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

G. Inspectors

- The Court may appoint one or more inspectors whose duty it is to assist and advise the liquidator. Any such appointment is discretionary (Section 41).
- Inspectors do not have defined powers under the Act and cannot direct the liquidator to take, or refrain from taking, any action.
- The Act does not contemplate remuneration to the inspectors (which is therefore in the discretion of the Court).

H. Secured Creditors

- Generally, secured claims rank in priority to the liquidator's charges, costs and expense; however, there are cases where the courts have allowed in priority to secured claims the costs of preserving and realizing assets if such costs incurred also benefitted the secured creditor(s) in question. Secured creditors may elect to be treated in one of the following ways: (i) be excluded from the liquidation proceedings and realize upon their security in any manner authorized by law; (ii) release their security and prove their claims as unsecured creditors; or (iii) prove and value their security, thereby participating in the liquidation proceedings, and then proving a claim for any resulting deficiency (such deficiency claim being an unsecured claim).

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

I. Priorities

- The property of the company shall be applied in satisfaction of its debts and liabilities, and the charges, costs and expenses incurred in winding-up its affairs (Section 93).
- All costs, charges and expenses properly incurred in the winding-up of a company, including the remuneration of the liquidator, are payable out of the assets of the company, in priority to all other claims (Section 94).
- The Act does not contain detailed provisions regarding a claims procedure or a ranking of priorities for payment of claims with the exception of priority given to claims of wage earners for three months' arrears of salary or wages due (Section 72). The Act does set out a scheme of priorities with respect to insurance companies (Section 161) and for authorized foreign banks (Section 158.1).
- Generally, property would be distributed to secured creditors first, for winding-up costs second (subject to sometimes being ahead of secured claims, as noted above), to the preferred employee claim third, and then ratably among all other unsecured claims. However, given the absence of statutory direction or detail on point, there may be unique priority issues that require the guidance of the court.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

J. Reviewable Transactions

- Section 96 provides that all gratuitous contracts, or conveyances or contracts without consideration, or with a merely nominal consideration, made by a company within three months immediately preceding the commencement of the winding-up or at any time thereafter, are presumed to have been made with intent to defraud the creditors of the company. Section 99 provides that the contracts or conveyances made with the intent to defraud or delay creditors of the company being wound-up and that have the effect of impeding, obstructing or delaying the creditors or injuring them are void.
- Section 97 provides that all contracts by which creditors are injured, obstructed or delayed made by a company unable to meet its engagements and in respect of which a winding-up order is afterwards made, with a person who knows of the inability of the company to meet its engagements or has probable cause to believe that such an inability exists, or where that inability has become public and notorious, are presumed to be made with an intent to defraud the creditors of the company.
- Section 98 provides that any contracts or conveyances for consideration by which creditors are injured or obstructed which are made within thirty days before the commencement of the winding-up or any time thereafter by a company unable to meet its engagements, with a person ignorant of such inability or before such inability becomes public and notorious, are voidable and may be set aside by the Court.
- Section 100 provides that any sale, deposit, pledge or transfer of any property of the company made by a company in contemplation of insolvency by way of security or payment to any creditor whereby such creditor obtains or will obtain an unjust preference over other creditors, is void and the subject thereof may be recovered upon application for such relief.
- Section 101 provides that every payment made within thirty days before the commencement of the winding-up by a company unable to meet its engagements in full to a person who knows of that inability or has probable cause for believing that inability exists, is void and the amount paid may be recovered back by the liquidator.

Case Study #1 — Questions and Answer Guide…cont'd

TORYS

K. Crown

- A unique aspect of WURA, unlike other Canadian bankruptcy and insolvency statutes, is that it does not bind the Crown. Three resulting implications are that:
  1. a stay of proceedings pursuant to the Act does not bind the Crown (although in practice, the likelihood of the Crown taking enforcement steps independently of the liquidation may be small);
  2. it is not possible to compromise Crown claims in a restructuring (but, given the unlikelihood of WURA being used to effect a restructuring, this too may not be a significant concern); and
  3. with respect to the priority of Crown claims vis-à-vis other stakeholders, the Crown does not lose the priority these claims are given under other statutes or pursuant to the Crown's common law prerogative.

L. Fees / Levy

- There is no levy payable on distributions under the Act. The Act distinguishes between charges, costs and expenses incurred in the winding-up of the company and debts and liabilities of the company. Charges, costs and expenses are to be paid in priority to all other claims (Section 94).

M. Restructuring Proposal

- The Act contains provisions for compromises and arrangements with a company that is already being wound-up under the Act and specifically provides that a liquidator may, with the approval of the Court, propose a compromise or arrangement to creditors. The Court may, upon application, order a meeting of creditors, or a class or classes of creditors, for purposes of considering a proposed compromise or arrangement.
- If a majority number, representing ¾ in value, of the creditors or class or classes of creditors present and voting at the meeting approve of the arrangement or compromise, and if it is sanctioned by the Court, the arrangement or compromise becomes binding upon all creditors and the liquidator (Sections 65 and 66).
- Restructuring provisions are very antiquated and cursory — despite the 1997 change of the name of the Act (from *Winding-up Act* to WURA), there is virtually no focus on restructuring in practice — it is almost exclusively a liquidation statute.

Case Study #2 — Questions Only

TORYS

Usual Caveat: The facts described below are for illustrative purposes only. This case study is intended only as a fictitious but practical exercise to provide context to the subject matter.

THE FACTS

- ABC Inc. is a private corporation incorporated in 2010 under the *Canada Business Corporations Act (*CBCA*).*
- ABC Inc. is a manufacturing company with a head office and manufacturing facility in Toronto, Ontario. It sells / distributes its products across Canada and the United States.
- In 2015, ABC Inc. acquired the shares of its biggest competitor, whose head office and manufacturing facility is located in Vancouver, British Columbia. This new company is a subsidiary of ABC Inc.
- ABC Inc. has always had Big Bank as its secured operating lender. The credit agreements were signed in 2010, together with the following security documents:
  a) general security encumbering all of ABC's real and personal property;
  b) general assignment of accounts;
  c) pledge of certain securities;
  d) security under the terms of Section 427 of the *Bank Act,* notice of which was published on February 3, 2010, for credit advances granted on February 28, 2010; and
  e) mortgage encumbering all of the real properties of ABC Inc.

Case Study #2 — Questions Only…cont'd

TORYS

- The B.C. subsidiary, since its acquisition by ABC Inc., is co-debtor of all of the credit facilities granted by the Big Bank and has granted similar security to that of ABC Inc. All of the security has been registered in accordance with the respective *Personal Property Security Act* in Ontario and in B.C., and also under the respective *Mortgages Act.*
- Currently, two (2) technical defaults (EBITDA and inventory covenant, and failure to deliver an insurance certificate showing the renewal of existing policies and the Big Bank as loss payee) have been tolerated for about four (4) months.

Big Bank has consulted you and asked for your recommendations regarding the analysis of ABC Inc.'s financial situation — specifically, it wants to know what, if anything, it should do.

QUESTION #1

1. What additional facts or documents do you require in order to assess the position of the Big Bank and be in a position to make a recommendation?
2. Based on what you know from the facts above, what preliminary thoughts do you have as to a recommendation?
3. The Bank informs you that certain pieces of equipment, including a truck, were recently seized by a sheriff executing upon a judgment, and that the assets are to be sold in two (2) days' time. The Bank is desperate to stop the sale to prevent its collateral from being eroded, and asks you what can be done.
   a) What is your recommendation to the Bank? Should the sale be stopped?
   b) What additional means does ABC Inc. have to stop the sale?

Case Study #2 — Questions Only…cont'd

TORYS

4. ABC Inc.'s shareholders, several of whom are on the board and/or in senior management, have each personally guaranteed the entire loan to Big Bank. They are concerned about their personal exposure if their guarantees are called by Big Bank, and they ask for your advice. Can you advise them and what would you recommend to them under the circumstances?
5. Your recommendations to Big Bank, if acted upon, will be prejudicial to some stakeholders. The Bank asks you if that matters?

At a subsequent meeting, you learn that the facilities located in Toronto are undergoing an expansion. The work began in July 2017 and is not yet completed. At the present time, ABC Inc. cannot pay the various parties who have been performing the work.

QUESTION #2

6. Regarding potential lien claims, what formalities should have been completed by ABC Inc. and these parties?
7. What remedies are available to the parties or companies that participated in the work?
8. In determining how to respond to these lien claims, what considerations ought Big Bank have in mind?
9. In determining how to respond to these lien claims, what considerations ought ABC Inc. have in mind?
10. ABC Inc. clearly requires additional funds, by loan or otherwise, in the very short term. Should Big Bank loan additional monies and what should it consider in making this decision given the construction liens?

Case Study #2 — Questions Only…cont'd

TORYS

Big Bank is dissatisfied with the company's financial situation, and since one of ABC Inc.'s customers is preparing to make a payment of several million dollars, the Bank asks for your advice on one or more means of recovering these incoming monies. However, the security instruments stipulate that they can only be exercised in case of default, and the only defaults that currently exist are of a technical nature (as described above) and have been tolerated for about four (4) months.

QUESTION #3

11. Big Bank asks you whether and how it can obtain these monies, and whether it is advisable?
12. Big Bank asks you whether it would be exposed to potential liability if it were to take action to recover this account receivable?

ABC Inc.'s Board of Directors has invited you to one of the meetings of the Board, and asks you about the following:

QUESTION #4

13. Whether it can file a notice of intention, should a plan of arrangement be filed under the CCAA but be rejected by the creditors?
14. Whether it can file an application under the CCAA?
15. Whether it can file a notice of intention, given the urgency, and then transfer the reorganization proceedings to the CCAA?
16. The directors' potential liabilities and the means available to protect them? Can you both advise the directors in their capacity as directors and the company regarding its financial situation?
17. Should they pay certain claims involving potential directors' liability but which are ordinary claims in a context of bankruptcy, such as the HST, which are six (6) months late, representing a total of about $800,000?

Case Study #2 — Questions Only…cont'd

TORYS

Assuming that ABC Inc. has been a public company since 2010 and has commenced proceedings under the CCAA:

QUESTION #5

18. What can the company offer ordinary creditors? Anything other than cash? What should the terms of the Plan be?
19. How are Crown claims treated:
    a) In proceedings under the BIA?
    b) In CCAA proceedings?
    c) Under corporate reorganization such as under the CBCA or OBCA?

You are now consulted by the President of ABC Inc. who informs you that, in his opinion, the best solution is to proceed with the sale of the company.

QUESTION #6

20. How could you proceed with the sale of shares or assets if, at this time, it is taken for granted that ABC Inc. is clearly insolvent and in default under the terms of the agreements with the Big Bank, even though no notice has been transmitted to ABC Inc. by the Bank as yet?

Case Study #2 — Questions Only…cont'd

TORYS

Keeping in mind that this is a public company and the members of the Board of Directors have personal interests regarding the sale of shares or assets:

QUESTION #7

21. What would you recommend regarding the solicitation and analysis of offers to purchase the assets?

You have been appointed monitor of ABC Inc.'s assets pursuant to the CCAA and you find yourself in the following situation: an offer to purchase has been duly accepted by ABC Inc., according to your recommendations, but the day after acceptance of this offer, a new buyer files an unconditional offer with you for a purchase price which is $6,000,000 higher than the offer already accepted.

QUESTION #8

22. What do you do? What do you recommend?
23. What will appear in your report to the Court, which would be filed within the context of the application for approval of the transaction by the Court?

Case Study #2 — Questions Only…cont'd

TORYS

If you are engaged to advise a buyer interested in ABC Inc.:

QUESTION #9

24. What are the pros and cons of an asset v. share deal?

You are now consulted by an ordinary creditor who asks you whether a committee of inspectors or creditors will be set up in connection with:

a) the bankruptcy of ABC Inc.

b) a proposal filed by ABC Inc.

c) a plan of arrangement filed by ABC Inc. under the terms of the CCAA.

QUESTION #10

25. How do you answer him regarding each of these events?

26. What would be the powers of the committee of inspectors or creditors in each of these three (3) events?

If ABC Inc., instead of being a corporate entity, were a limited partnership under the laws of Ontario:

QUESTION #11

27. Could it file an assignment of property under the BIA?

28. Could it file a notice of intention and/or a proposal under the BIA?

29. Could it file a plan of arrangement under the CCAA?

30. Could it take advantage of the winding-up procedures prescribed in the CBCA or a provincial equivalent?

www.torys.com

TORYS