

**Presentation to
NACM - Canada**

Insolvency in Canada

Justin Fogarty, *Davis LLP*
Hubert Sibre, *BCF LLP*

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SUMMARY

- Quick Review of Applicable Legislations in Canada
- Goals Overview of Available Legal Options
- Discussion of Legislative Changes
- Current Domestic and Global Trends in Realization on Bad Credit. Avoiding Risk
- Early Warning Signs



Insolvency Legislation in Canada

Available Legislation

- Winding-up and Restructuring Act (WRA)
- Companies' Creditors Arrangement Act (C-36 or CCAA)
- Bankruptcy and Insolvency Act (BIA)
- Receivership
- Civil Code of Quebec (CCQ) and other common law legislation

Some Basic Principles

CCAA = Monitor – Monitors and assists the debtor in the process

Proposal = Trustee – Monitors and assists the debtor in the process

I.R. = Trustee – Principles of preservation
See terms of the order

Bankruptcy = Trustee – Seizure and powers
Possibility of a double mandate
represents the mass and one or more of the secured creditors

Bankruptcy and Insolvency Act

- Notice of intention to file a proposal
- Interim Receiver
- Proposal
- Bankruptcy
- Receivership

Notice of Intention to File a Proposal

- Day 1: A notice of intention to file a proposal is filed
- Day 10: A statement of changes in cash is filed
- Day 30: A proposal is filed OR the court is asked for a time extension

Time extension

- ✓ Maximum cumulative extension of 5 months
- ✓ Maximum individual extensions of 45 days

Proposals

- Suspension of procedures
 - Applies to all ongoing or future procedures
 - Even secured creditors UNLESS:
 - ▶ Assets were taken into possession before procedures were initiated
 - ▶ The 10-Day Notice was served and expired or agreed to by the debtor
- Election process as in CCAA
- Approval by the court
- All types of proposals are possible
 - Lump sum
 - Percentage dividend
 - Any other combination

Interim Receiver

- According to section 47 of the BIA
- The latest trend is to combine this tool with other proceedings
- Increasingly broader objectives and powers
- As in the case of the CCAA, one must refer to the order
- The interim receiver's fees may enjoy priority over the rights of creditors
- The end of the mandate is not clearly defined

Bankruptcy

- When a debtor produces a balance sheet showing that he is insolvent
- When a debtor transfers, removes, hides or disposes of property with the intention of defrauding or delaying its creditors
- When a debtor defaults on a proposal
- When a debtor ceases to honour his commitments
- Must have a minimum debt of \$1,000

Bankruptcy (continued)

First Creditor's Meeting

- Meeting Objectives
 - Confirm or oppose the nomination of the Trustee
 - Enable creditors to ask the debtor or Trustee questions
 - Appoint inspectors
 - ▶ May become very important towards maintaining control over the Trustee
 - ▶ Maintain rigor in the decision-making process

Receivership

- Process by a secured creditor
- Does not necessarily involve a Trustee
- May be paired with a bankruptcy
- The receiver (agent) represents only the creditor's interest
- May take over the powers of an interim receiver
- Monitoring process less rigorous than in bankruptcy
- The process is subject to applications other than non-competitive acts
 - In Québec – CCQ for hypothecary delays
 - Bank Act (Section 427)

Winding-up and Restructuring Act

- Federal act
- Applies only to certain types of companies under federal jurisdiction
 - Banks
 - Insurance companies – Les Coopérants (early 1990's)
- Rarely used

Companies' Creditors Arrangement Act

- Older act
- Application criteria
 - Minimum of \$5 million debt
- Results from orders issued by the court
- Very costly process
- Application is similar to a holding proposal

Advantages

- Very flexible – made for adapting to complex situations
- The Court has a lot of discretion
- Bankruptcy is not an automatic consequence of failure
- The approach is highly «pro-restructuring»
- May use an interim receiver (as in the BIA)

Other principles of the CCAA

- Classifying creditors
 - Ordinary, secured and others
- Applicable to a group of companies, even if one subsidiary is not insolvent
- Exclude financial contract, such as letter of credit
- Suppliers can always ask for COD payments
- Cannot compel someone to advance new money or new credit
- The initial order date is fundamental

Trends

- Appointment of a "Chief Restructuring Officer" (CRO)
- Establishing priority expenses, including:
 - Administrative charge
 - D & O charge
- Order that provides for trade continuity with and payment of suppliers deemed to be essential – Critical vendor principle
- Directors and officers' compensation adjusted with their new level of responsibilities and risk
- "DIP-financing" – to be detailed
- Vulture funds – to be detailed
- Important recent evolution of situation affecting third parties within the case law
 - Examples:
 - ▶ Eaton
 - ▶ Air Canada
 - ▶ AT&T Canada
 - ▶ JTI - MacDonald

The issued Orders are primarily:

- Initial Stay
- Extension
- Specific
- Sale of assets
- Claim bar date and process
- Presentation of plan to creditors
- Approval of plan by Court
- Closing Order

Content of the Initial Stay Order

- Stay of proceedings
- Obligation to continue to do business
- Continuation or terminating contract
- Stay of claim against directors and officers
- Authority to repossess property
- Powers to restructure (including to terminate agreements and contracts)
- Authority to sell assets
- Critical vendor provisions
- Specific provisions with respect to termination of leases
- Confidentiality provisions
- Directors and officers indemnification and charge
- Powers of the monitors
- Protection provision in favour of the monitor
- Administrative charges
- Stay of preference provisions
- Method of service of documents and information
- Request assistance of other Courts

What is a DIP Lending?

- Specialized form of asset based loan - not a bet that debtor will be successfully restructured
- Entitles management to stay in control
- Not contemplated by the *CCAA* or *BIA until now*
- May prime pre-filing security

Vulture funds

- What to do when assigning your debts
 - There are often more than one potential buyer
 - Used more often in the US
 - Can be done by commercial banks, investment banks, edge funds and private equity firms

TYPES OF DEAL

- With recourse
- Without recourse
- Blocking position

- Be careful not to
 - Be in default under the agreements
 - Always act expediently

Particularities of a blocking position

- The objective is for the payee to obtain control through the «blocking» of more than 1/3 of creditors in a specific class
- Very often allows for transfer of those rights to somebody else without consent of the initial creditor
- The objective is to obtain
 - Agreement to vote in favour of the plan
 - Not to take action detrimental to the plan
 - The creditor is obligated to assign its claim in the future (sometime it is just an option)

Insolvent debtors with assets in more than one jurisdiction

Either ...

- Recognition of a main foreign proceeding
- Multijurisdiction protocol (concordat)
- Competing insolvency processes

Recognition of foreign proceedings in Canada

- CCAA, art. 18.6
 - Mainly subsection 2
(18.6(2)) *Powers of Court*
«*The Court may, in respect of a debtor company, make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in a coordination of proceedings under this Act with any foreign proceeding.*»

Trends

(also in Canada)

- Avoid multiple conflicting proceedings
- Coordinate efforts
- Hopefully designate one principal proceeding (one jurisdiction)

Questions to be raised

- Who is the chief restructuring office ?
- What happens to the directors and officers' responsibilities?
- How is the «critical vendor provisions» applied in Canada?
- What about 30 day goods or in transit ?
- Can I still apply set off principles ?
- How does a debtor sell its assets: the Stalking horse bidding process and others
- What should I do when I first learn of the issuance of a C-36 Order ?
- What are the opportunities for suppliers to influence the process ?
- What are the indicators available to assess the potential value of its indebtedness ?
- How can I found out if I can assign my debt?

Remember

- Obtain a copy of the order
- Negotiate an agreement A.S.A.P.
- Do not be surprised if the Orders affect third parties' rights
- Devise a strategy very quickly
- You may contest provisions within the Orders, but only after the fact

Current Trends

- Lack of capital in the marketplace
 - Financial Institutions are not realizing on non-performing loans
 - At the same time they are not making new credit available
 - Hedge (Vulture) Funds are beginning to play a role again
 - Government is stepping in (Abitibi, GM, Chrysler)
 - EDC, BDC playing bigger role
 - More pre-package deals are occurring

Current Trends (Continued)

- Avoidance of litigation
- Evolution of court system across Canada – the standard order
- Better international cross border treatment – still there are conflicts (COMI) (Unicital Treaty)
- Important to be more creative on complex matters
- Old approach may not work given shifting paradigm

Preferences and other Remedies

Section 81 of the BIA – Supplier Remedies

Eligibility Criteria

- The claimant must present proof of claim for property to the Trustee

- In the 15 following days, the Trustee must:
 - Accept the proof of claim

OR

- Reject the claim; the claimant may appeal within 15 days following the notice of dispute

Section 81 of the BIA

Eligibility Criteria of an Unpaid Supplier

- The supplier presents proof of claim to the Trustee
- The request must be made within 30 days following the delivery of the goods and:
 - The goods are in the possession of the Trustee
 - The goods may be identified in a precise manner
 - The goods are not fully paid
 - The goods are in the same condition as they were when they were delivered
 - The goods are not subject to any arm's length selling agreement



Early Warning Signs

Early Warning Signs

Macro

- Client lags in technological shift
- Competitors increase market share
- Client's focus becomes internal not external
- Innovation trend is flat
- Business practices become questionable or suspect
- Investment increases unjustifiably

Micro

- Officers absent from company premises
- High rate of employee turnover
- Deterioration in product or service quality
- Dependence on one client or one supplier
- Obsolescence of a company's installations
- Sporadic or late payments
- Omission or holdback of DAS/GST/QST

Incidence of causes of decline

➤ Internal causes	%	
▪ Poor management	84	
▪ Inadequate financial controls	60	
▪ Acquisitions	72	
▪ Financing policies	84	
▪ Big projects	20	
▪ High costs vs. Competition		56
▪ Poor marketing	20	
➤ External causes		
▪ Changes in market demand	68	
▪ Competition	44	
▪ Adverse commodity price trends		20

How to Protect Yourself

- Regularly visit your client at his place of business
- Hold regular meetings with management
- Request financial statements on a regular basis
- Review the RDPRM (PPSA)/Property registry/Corporate record on a regular basis
- Obtain a disclosure of goods on consignment
- Participate in credit groups for your industry

Dealing with creditors

The debtor usually

- Begins dialogue with creditors where no alternatives exist
- Typically, creditors still require and need the debtor's business – the debtor will use this tool to leverage its relationship, payment terms and ultimately for the vote on the proposal
- Creditors actually have more protection post-filing since they can potentially demand COD/CIA terms
- The Debtor begins dialogue with key, if not all customers on trying to receive payment of receivables early
- Very common for the debtor to allow customers significant discounts for early payment of outstanding invoices
- Factoring or sale of certain receivables



Enforcing your rights

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Method to secure a debt

Red

Mortgage (immovable assets)
Movable mortgage or PPSA
Possession (retainer or deposit)

Orange

PMSI or Instalment sales (Quebec)
Quebec's rights of redemption or resolution
Leases (true leases vs. financing leases)

Yellow

Consignment sales
Guarantee (general or specific)
Credit papers (in general)

Other

Buyback agreements are contractual rights
Licences = a complete different world !

Enforcing your rights

REASONABLE DELAY

The execution of a contractual right must not be exercised abusively

- Commercial Reasonableness
- BIA – 10 day notice period
- PPSA – Further notice periods
- Mortgages – Further notice periods

Beware of:

- Insufficient time for client to find alternatives



The Right Contractual Provisions

An Opportunity you can't miss !

- Vendor usually seduces purchaser.
- Only once is your vendor client being seduced.
- At the time of the credit application.
- Terms and Conditions are easier to obtain at this point.
- One document to deal with the relationship



Certain Important Elements Terms and Conditions of Sale

Elements

- Authority of Client's representatives delay
- Client's Acceptance of Goods
- Returns
- Terms of Payment
- Late Charges and Interest
- Repayment of Fees
- Allocation of payments
- Condition of Product

Elements (continued)

- Limitation Period
- Modification of Terms
- Notice
- Governing Law and Jurisdiction
- Entire Agreement
- Modification of Terms
- Other Provisions