

# Bankruptcy and Insolvency

Section M of Stikeman Elliott's *Doing Business in Canada*





# Bankruptcy and Insolvency

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# Bankruptcy and Insolvency

## LEGISLATIVE FRAMEWORK

The majority of Canada's insolvency rules are enshrined in two principal federal statutes – the *Bankruptcy and Insolvency Act* (BIA), and the *Companies' Creditors Arrangement Act* (CCAA). In addition, the *Winding-up and Restructuring Act* specifically governs the liquidation and restructuring of certain types of companies including banks, insurance companies and trust companies, and several provincial statutes also deal with creditors' rights.

Both the CCAA and the BIA can be used for reorganization proceedings and liquidations. The practice has developed to utilize the CCAA for medium to large cases and the BIA for small to medium cases because the relative flexibility of the CCAA affords greater latitude of action to the reorganizing debtor.

## RECENT DEVELOPMENTS: BILLS C-55, C-62 AND C-12

Recent amendments to Canadian insolvency legislation have resulted in a number of significant changes. The amendments have taken the form of a series of bills whose interrelationship is unusually complicated. The legislative history of the amendments to date will be of interest to some readers and is accordingly recounted here.

Bill C-55, *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, was passed in November 2005, and proposed to introduce a new set of key procedural and substantive amendments to the Canadian insolvency rules. Now referred to as Chapter 47 of the Statutes of Canada, 2005, Bill C-55 was passed with the understanding that a more thorough review of the Bill, and possibly consequential amendments, would take place before it was proclaimed into force.

That review culminated in Bill C-62, *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005*, which sought to make some technical and some substantive changes resulting from Bill C-55's rushed enactment. Bill C-62 had passed through the House of Commons and had been given its first reading in the Senate when the first session of the 39<sup>th</sup> Parliament was prorogued in mid-September of 2007, effectively killing Bill C-62. Thus Bill C-12, a reprint of Bill C-62, was introduced in the ensuing second session of the 39<sup>th</sup> Parliament. Bill C-12 was passed by the House of Commons on October

29, 2007,<sup>1</sup> reviewed and reported on by the Standing Senate Committee on Banking, Trade and Commerce on December 13, 2007,<sup>2</sup> and passed by the Senate the same day. The Bill was given Royal Assent on December 14, 2007 and the provisions of both Chapter 47 and Bill C-12 will come into force upon proclamation, which is expected within 6-12 months.<sup>3</sup>

Canada's Ministers of Labour and Industry agreed to have their departments monitor how the new legislation is being implemented and will report back to the House of Commons and Senate within a year, advising on technical improvements that ought to be made.<sup>4</sup> The Standing Senate Committee on Banking, Trade and Commerce plans to hear from insolvency stakeholders, beginning in February 2008, to assist Parliament and the departments in preparing potential technical amendments.<sup>5</sup>

Key changes introduced by Bills C-55 and C-12, include the following:

1. **Wage Earner and Pension Protection** – Chapter 47 enacts a new law, which establishes the Wage Earner Protection Program (WEPP) to compensate individuals for amounts earned, but not paid, during the six months prior to bankruptcy or receivership up to a maximum of the greater of \$3,000 or an amount equal to four times the maximum weekly earnings under the *Employment Insurance Act*. These unpaid wages will also receive enhanced protection through a “super priority” over the current assets of the firm, with claims for unpaid wages now ranking higher than those of secured creditors. Unpaid pension contributions are likewise given additional protection.
2. **Interim (DIP) financing** – Chapter 47 enables a court to authorize interim financing, giving priority to the provider of the interim financing over secured creditors, as well as possibly others. Bill C-12 adds that a secured creditor whose interests may be affected must be given notice.
3. **Protection of Insolvency Professionals** – A trustee may not be subject to successor employer liability if the trustee carries out the business of the debtor or continues employment of its employees.
4. **Receivers and Interim Receivers** – Receivers and monitors will have to be licensed as trustees in bankruptcy. The new legislation sets out

<sup>1</sup> Canadian Association of Insolvency and Restructuring Professionals (CAIRP), *Bulletin* (November 2007) BUL07-3, “Bill C-62 Revived as Bill C-12,” online at: [http://www.cairp.ca/english/whats\\_new/item05.asp](http://www.cairp.ca/english/whats_new/item05.asp).

<sup>2</sup> Standing Senate Committee on Banking, Trade and Commerce, “Fifth Report” (December 13, 2007), online at: [http://www.cairp.ca/English/whats\\_new/item04.asp](http://www.cairp.ca/English/whats_new/item04.asp).

<sup>3</sup> Note that most of the provisions may technically be in force now as Royal Assent has been given to Bill C-12 and therefore those provisions which were not specifically identified in section 113 as coming into force at a later date as fixed by the Governor in Council, came into force upon Royal Assent being given. However, those same provisions that are technically in force now make amendments to Chapter 47, the provisions of which have not yet been proclaimed into law. Ultimately then, while these provisions of Bill C-12 have technically come into force, they will “practically” (i.e. effectively) come into force when the relevant provisions of Chapter 47 that they amend come into force, which will also be upon a date or dates fixed by the Governor in Council as per section 141 of Chapter 47 (also see provisions 132-135 and 140).

<sup>4</sup> Canadian Association of Insolvency and Restructuring Professionals (CAIRP), *Bulletin* (December 2007) BUL07-05, “Bill C-12 Passed by Senate, Given Royal Assent,” online at: [http://www.cairp.ca/english/whats\\_new/item09.asp](http://www.cairp.ca/english/whats_new/item09.asp).

<sup>5</sup> *Ibid.*

the maximum length of the interim period, clarifies the role and powers of interim receivers, and adds a test for when a receiver may be appointed.

5. **Collective agreements, other agreements, and critical suppliers** – The legislation confirms that a collective agreement, unless there has been an agreement to revise it by both parties, remains in force. A debtor, however, can apply to court for an order to bargain. Where the collective agreement is revised as a result, the bargaining agent may make a claim, as an unsecured creditor, for an amount equal to the value of the concession. With respect to other contracts, a debtor company may apply to court to disclaim an agreement – although certain contracts, for example eligible financial contracts, are excepted from this rule – and a court may grant the disclaimer if satisfied of its necessity to the viability of a proposal or plan. A debtor can also apply to court to have a person be declared a critical supplier, upon which the court may order a person to supply goods and services on terms and conditions that are consistent with the supply relationship or that the court considers appropriate.
6. **Unpaid suppliers** – The new legislation corrects a timing problem and continues to allow unpaid suppliers to repossess goods within a short period after the bankruptcy or receivership.
7. **Eligible Financial Contracts** – Eligible financial contracts are not eligible to be disclaimed and Bill C-12 provides that the definition of “eligible financial contracts” will be included in the rules rather than legislation, so as to make future modifications more flexible.
8. **Subordination of Equity Claims** – A creditor will not be entitled to claim a dividend in respect of a claim arising from the rescission of a purchase and sale of a share or unit of the bankrupt or debtor company until the claims of all other creditors have been satisfied.
9. **International Coordination** – New provisions, based upon the United Nations Commission on International Trade Law Model Law, have been included to promote cooperation in cross-border insolvency proceedings.

## LIQUIDATION REGIMES

### Bankruptcy and Insolvency Act

The liquidation and bankruptcy scheme under the BIA may be applied in insolvencies of almost any type of entity including individuals, partnerships, associations and corporations. The BIA defines “corporation” to include not only any company incorporated and authorized to do business by or under a federal or provincial act, but also any incorporated company that has an office or property in, or carries on business in

Canada. The definition does not include certain entities in the financial services sector such as banks, savings banks, insurance companies, trust companies, loan companies or railway companies, although holding companies of such entities are subject to the BIA.

Among other things, the BIA allows the trustee in bankruptcy to realize on the assets of the bankrupt, determine the propriety of claims against the estate, and distribute the proceeds. Secured creditors are generally not affected by this proceeding and can, therefore, proceed to exercise their rights. Generally, a trustee takes the property of the bankrupt, subject to the existing rights of third parties. For example, contractual rights of termination are binding on a trustee. Certain types of set-off are permitted. A trustee can disclaim any lease under which a bankrupt is a tenant. Unpaid suppliers are given the right, in certain circumstances, to reclaim goods delivered within thirty days of the bankruptcy.

The trustee is able to challenge payments or transfers of property that have taken place within defined periods prior to the bankruptcy if they have had the effect of defeating or prejudicing the claims of creditors. Further, certain provisions have been added to facilitate multi-jurisdictional insolvencies and with respect to the insolvency of securities brokers.

### **Winding-up and Restructuring Act**

As mentioned above, liquidation provisions under the federal *Winding-up and Restructuring Act* (WURA) apply to federal or foreign banks, federal or provincial loan or trust companies, and federal, provincial or foreign insurance corporations carrying on operations in Canada. Although WURA can apply to “trading companies” (except for corporations incorporated under the CBCA), non-financial institution corporations are generally liquidated under the BIA. Although it is framed in different terms, WURA operates in much the same way as the BIA.

### **Receiverships**

Liquidation under a court-administered receivership applies where a provincial court has been given jurisdiction under the BIA or a specific provincial statute (e.g. *Courts of Justice Act* (Ontario)) to appoint a receiver to realize on the assets of a business corporation for the benefit of its creditors. This process, which has become less popular in recent years due to case law imposing employee obligations on receivers, is more often used where continuing the operations of the debtor to maintain value is important. Secured creditors may also privately appoint receivers under their security documents to realize on the assets subject to their security interests. Unpaid suppliers are given the right, in certain circumstances, to reclaim goods delivered within thirty days of the debtor in receivership.

## REORGANIZATION REGIMES

### **Bankruptcy and Insolvency Act**

The reorganization of creditor claims under the proposal provisions of the BIA applies to the same types of corporations to which the BIA liquidation provisions apply. Under the BIA, a company may deliver a proposal to its creditors or give notice of its intention to file a proposal. This effects a thirty-day stay period (which may, at the discretion of the court, be extended for up to six months) against the government and against other secured and unsecured creditors, other than any secured creditors who have taken possession of their security or given notice of their intention to enforce their security at least ten days before the first filing of the notice or proposal. During the stay period, the business is monitored by a trustee while the debtor attempts to negotiate an acceptable proposal with its creditors. If a proposal is not filed within the allowed time, the debtor is deemed to have made an assignment in bankruptcy.

The proposal may be made to unsecured creditors only, or to both secured and unsecured creditors. Creditors with proven claims are entitled to vote on the proposal and are divided into classes based on commonality of interest, with all of the unsecured creditors normally comprising one class. The approval of a proposal by a particular class requires a favourable vote by creditors representing a majority in number and two-thirds in value of those voting. If the creditors accept the proposal, it is submitted to the court for approval.

Subject to certain exceptions for eligible financial contracts, the BIA provides that contractual terms providing for the termination, amendment or acceleration of payment under a contract simply by reason that a person is insolvent or has filed a notice of intention or a proposal will be unenforceable. Similar clauses in leases of real property or licensing agreements that are triggered by the non-payment of rent or royalties will also be unenforceable. Any further supply of goods and services may, however, be on an immediate payment basis.

### **Companies' Creditors Arrangement Act**

Reorganization of creditor claims under the federal *Companies' Creditors Arrangement Act* (CCAA) permits an insolvent company to continue its business while attempting to reorganize its affairs by providing for a stay of proceedings during the reorganization period. Banks, insurance companies, railways and federal loan and trust corporations are not subject to the CCAA, although provincial loan and trust corporations might be. In order to take advantage of the CCAA, aggregate claims against the corporation must exceed \$5 million.

In response to an application by any eligible CCAA debtor company, creditor, trustee in bankruptcy or liquidator, a court may grant an order

directing the filing of a plan of compromise or arrangement by the debtor company, and the meeting of the creditors of the debtor company to consider and vote on the terms of the plan. Unlike the BIA, where the process is automatic, the decision to grant relief in CCAA proceedings is discretionary. In particular, a court may deny an initial CCAA application where support by the creditors is slim and there appears to be no chance that a plan will be successful. In order to succeed, the debtor company's plan of compromise or arrangement must be approved by a majority in number representing two-thirds in value of the creditors in *each* class. The CCAA requires that secured and unsecured creditors must be in separate classes. Further clarification will be determined on the same criteria as under the BIA.

The court is given complete discretion as to whether to grant a stay, the scope of the stay, and the time period in which the stay is in effect (except that the original stay period cannot exceed 30 days). In particular, the court must be satisfied that a stay is in the best interests of the debtor and creditors (in accordance with the specifics of the order). Once a stay is granted, it applies to both secured and unsecured creditors and usually prevents the termination of contracts between the debtor and other parties, although eligible financial contracts are exempted. With the support of major creditors, a stay may also be extended indefinitely. The provisions of the CCAA facilitate multi-jurisdictional reorganization proceedings. Proceedings may also involve debtor-in-possession financing.

## CROSS-BORDER INSOLVENCIES

Both the CCAA and the BIA operate on the assumption of universal jurisdiction, extending authority and duty to control the assets of a debtor corporation wherever located (in Canada or abroad) for the benefit of creditors, wherever located. That notwithstanding, Canadian courts have traditionally been open to the concept of comity and the recognition of properly constituted foreign insolvency proceedings wherever this is consistent with public policy, and have generally encouraged coordination among various proceedings in all jurisdictions so that the restructuring or liquidation can proceed in a fair and orderly manner.

In exercising a wide discretion to recognize and enforce a foreign bankruptcy order, Canadian courts have taken a variety of factors into consideration including the compatibility of the foreign jurisdiction's insolvency rules with the Canadian regime. They have authority to tailor the terms and conditions of the orders that can be granted in the course of proceedings, and have formally recognized foreign orders and given assistance to foreign representatives in foreign restructuring proceedings (provided that such recognition is not inconsistent with Canadian laws or public policy).

Procedural harmonization has been implemented between courts in the US and Canada through the use of Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases and cross-border protocols, the primary purpose of which are to set out guidelines to coordinate and to promote the efficient administration of cross-border restructuring proceedings. Further, in an additional step towards facilitating coordination between Canadian and foreign courts in cross-border insolvency proceedings, Chapter 47 introduces certain elements of the UNCITRAL Model Law on Cross-Border Insolvency into the BIA and CCAA.

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