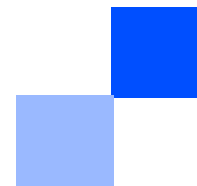


# Canada

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## SECURITY AND PRIORITIES

### 1. What are the most common forms of security taken in relation to immovable and movable property? Are any specific formalities required for the creation of security by companies?

Canada has a federal system of government. Legislative jurisdiction is divided between the federal legislature (Parliament) and the legislatures of Canada's ten provinces. Nine of the ten provinces are common law jurisdictions, with relatively minor differences from province to province, while Québec is a civil law jurisdiction.

Bankruptcy and insolvency law is a matter of federal jurisdiction. However, property and civil rights, which include the areas of real and personal property and the creation and realisation of security interests, are matters of provincial jurisdiction. Therefore, the interaction of provincial laws and federal bankruptcy and insolvency laws gives rise to some differences in law and practice from province to province, particularly in Québec.

Under federal banking legislation, specified banks can obtain a security interest on inventory of a borrower (*Bank Act (Canada)*). However, Bank Act security has become less common in recent years with the increased reliance on provincial personal property security legislation. Under the provincial regimes, the forms of security and their formalities differ depending on whether the collateral is real or personal property (known as immovable and movable property in Québec).

#### Real property

Lenders can take a security interest in real property by obtaining a charge/mortgage of land or a debenture from the borrower, known as an immovable hypothec in Québec. The security interest is registered against title to the property in the land registry office where the property is located. Where rents are included in the collateral, an assignment of leases and rents can also be registered on title as collateral security.

A charge/mortgage does not result in the transfer of any estate or interest in the land and is discharged on payment of the principal, interest and other amounts owing on the loan in accordance with the charge document. In Québec, an immovable hypothec must be granted through a legal practi-

tioner known as a notary (which is different from a notary public) in accordance with certain formalities.

#### Personal property

Each of Canada's provinces has enacted its own personal property security legislation. In all of the provinces other than Québec, there is an act known as the Personal Property Security Act (PPSA). In Québec, the relevant provisions are found in the Civil Code of Québec (CCQ).

The PPSAs and relevant CCQ provisions are roughly modelled on Article 9 of the US Uniform Commercial Code. The statutes contain relatively similar sets of conflict of law rules that establish which law governs the validity and effect of perfection or non-perfection of security interests (*see below, Formalities and perfection of security interests*).

Any agreement that creates or provides for an interest in personal property to secure payment or performance of an obligation falls within the scope of the applicable PPSA (or the CCQ in Québec), including financing leases and assignments intended as security. Assignments of accounts are deemed to constitute security interests and require registration or perfection, regardless of whether they secure payment or performance of an obligation. In addition, in all provinces other than Ontario, all leases for terms over one year must be registered whether or not they constitute financing leases.

#### Formalities and perfection of security interests

In the common law provinces, there are no prescribed formalities required for the creation of a security interest, although a grant of security is generally made in writing in order to ensure that the security interest will attach to the collateral (in other words, become enforceable against third parties). In Québec, a movable hypothec can be created with or without delivery of the movable property hypothecated. Where it is created with delivery, it may also be called a pledge. A movable hypothec without delivery and an immovable hypothec must be granted in writing.

Unless the parties have agreed to postpone the time of attachment, a security interest attaches when:

- The secured party (or its agent) obtains possession of the collateral or the debtor signs a security agreement that contains a description of the collateral sufficient to enable it to be identified;

- Value is given; and
- The debtor has acquired rights in the collateral.

Perfection occurs when a security interest has attached and, depending on the nature of the collateral, the secured party has taken possession of the collateral or has publicly registered notice of its interest in the collateral in prescribed form. Until perfected, a security interest is subordinate to the interests of persons who hold perfected security interests and certain statutory liens, as well as parties who assume control of the collateral through certain specified legal processes, such as a seizure after judgment. An unperfected security interest is not effective against a representative of creditors such as a trustee in bankruptcy. Priorities among holders of perfected security interests are determined according to rules established under the applicable PPSA or the CCQ in Québec.

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## 2. Where do creditors and shareholders rank on the insolvency of a company?

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### Insolvency and bankruptcy

Canada has two main federal statutes dealing with insolvency of corporations: the Bankruptcy and Insolvency Act (BIA) and the Companies' Creditors Arrangement Act (CCAA). Both statutes are in the process of major reform (see *Question 10*).

In Canada, the term "insolvency" is not synonymous with the term "bankruptcy". A corporation will be in a state of insolvency, or referred to as "insolvent", when it meets the legal definition of insolvency, for example, by being unable to meet its obligations as they generally become due. The term "bankruptcy" applies only to the situation where bankruptcy proceedings have been initiated under the BIA and the debtor's assets have vested in a bankruptcy trustee for the purpose of liquidation. A reorganising insolvent debtor is not referred to as "bankrupt" or as having gone into bankruptcy, although the process of reorganisation is sometimes referred to as being "under bankruptcy protection", as in the US.

In addition to the bankruptcy regime, the BIA includes a separate regime (known as a "proposal") which allows for the reorganisation of insolvent corporations and individuals. The CCAA is a restructuring statute which applies to larger corporations having aggregate claims in excess of C\$5 million (about US\$4.3 million).

### Ranking of creditors in a bankruptcy

When a corporation is adjudged bankrupt, its assets vest in a bankruptcy trustee who proceeds to liquidate the assets, subject to the rights of secured creditors.

A secured creditor holding valid, perfected security is generally unaffected by a bankruptcy and is therefore entitled to realise or otherwise deal with its security. A secured creditor who realises its security will be paid out of the proceeds of the

realisation and will be entitled to rank as an unsecured creditor for any remaining balance.

Unsecured creditors can be either preferred creditors or ordinary creditors. Preferred creditors are those who have a statutory priority over ordinary unsecured creditors under the BIA and include employees and landlords up to certain prescribed amounts. The balance remaining after payment in full of the preferred creditors is distributed rateably among the ordinary creditors. Shareholders are not entitled to share in any proceeds until creditors are fully paid.

The BIA provides that certain federal and provincial government or "Crown" claims, which would otherwise be entitled to priority over secured claims outside of a bankruptcy under applicable federal or provincial legislation, will rank as ordinary unsecured claims against a bankrupt.

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## 3. Are there any mechanisms used by trade creditors to secure unpaid debts?

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The "thirty-day goods" rule under the BIA provides that, where an unsecured trade creditor has sold and delivered goods for use in relation to the debtor's business and the debtor has not fully paid for the goods, the trade creditor can have access to and repossess the goods, provided that it presents a demand within 30 days of the delivery of the goods (subject to a number of conditions).

This rule does not come into effect as a consequence of the debtor seeking to reorganise under the CCAA or BIA proposal provisions.

Trade creditors are also free to secure their debtor's obligations by taking a conventional security interest (see *Question 1*).

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## 4. Are there any procedures (other than the formal rescue or insolvency procedures described in *Question 5*) that can be invoked by creditors to recover their debt?

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Proceedings against a debtor will be stayed in the context of restructuring proceedings under the BIA and CCAA, except with leave of the court.

On the bankruptcy of a debtor, unsecured creditors are stayed from exercising any remedy against the debtor or the debtor's property, or commencing or continuing any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged.

The bankruptcy of a debtor does not prevent a secured creditor from realising or otherwise dealing with any valid security in the same manner as if the bankruptcy had never occurred.

## RESCUE AND INSOLVENCY PROCEDURES

5. Please briefly describe rescue and insolvency procedures that are available in your jurisdiction. In each case, please state:

- The objective of the procedure and, where relevant, prospects for recovery.
- Companies to which it can potentially apply.
- How it is initiated, when and by whom.
- Substantive tests that apply (where relevant).
- How long it takes.
- The consents and approvals that are required.
- The effect on the company, shareholders and creditors.
- How the procedure is formally concluded.

### Bankruptcy

- **Objective.** The bankruptcy provisions of the BIA are intended to facilitate the orderly, economical and fair distribution of the property of a bankrupt among its creditors on a *pari passu* basis. Bankruptcy proceedings also provide an opportunity for an investigation to be made into the affairs of a bankrupt and challenges to be made to preferences, settlements and other reviewable or fraudulent transactions (see *Question 7*) so that all creditors share equally in the proceeds recovered from the bankrupt's assets.
- **Companies to which it applies, and how, when and by whom.** An insolvent person (which includes a corporation or partnership) that is resident, domiciled, or carries on business in Canada can make a voluntarily assignment into bankruptcy for the general benefit of its creditors. A court application for an involuntary bankruptcy order can be commenced against a debtor that owes the applicant creditor at least C\$1,000 (about US\$862) (on an unsecured basis) and has committed one or more of a number of specified "acts of bankruptcy" within the six months preceding the date of the petition. The most common act of bankruptcy cited is that the debtor has ceased to meet its liabilities as they become due.
- **Substantive tests.** A voluntary assignment results in bankruptcy without further formality. A debtor can oppose an application for involuntary bankruptcy by filing a notice of dispute with the court. In that case, an order will be made only after a hearing at which the allegations set out in the application have been proven.
- **How long.** A voluntary assignment results in an immediate bankruptcy. An unopposed application for a bankruptcy order will usually be granted within ten days to two weeks following service of the application on the debtor. The adju-

dication of an opposed application by a creditor tends to be expeditious and the case will usually be heard within a matter of weeks or months.

- **Consents and approvals.** A voluntary assignment must be filed with the Official Receiver in the locality of the debtor. An application for a bankruptcy order must be heard by the court and will be granted if the allegations set out in the application are proven and the requirements of the BIA have been met.
- **Effect.** On bankruptcy, the debtor's assets vest in a licensed trustee in bankruptcy subject to the rights of secured creditors. Proceedings by unsecured creditors asserting claims against the bankrupt's estate are automatically stayed, subject to the possibility of the stay being lifted by judicial order in exceptional circumstances. Creditors file proofs of claim with the trustee indicating the amount of their claims. The trustee must call a first meeting of creditors to be held shortly after the occurrence of the bankruptcy. At the first meeting of creditors, a committee of creditors (referred to as "inspectors") is appointed. The trustee carries out the administration of the bankruptcy under the supervision of the inspectors and the court. The trustee can sell assets that are not encumbered by security interests and distribute the proceeds to creditors according to the priorities set out in the BIA.
- **Conclusion.** After the assets in the bankrupt's estate have been fully administered and all proceeds have been distributed, the trustee can apply to be discharged. A bankrupt corporation that has not restructured under the BIA or the CCAA cannot be discharged from bankruptcy unless it has satisfied the claims of its creditors in full.

### Court appointed receiverships

- **Objective.** An enforcing secured creditor can make an application to the court for the appointment of an interim receiver under the BIA, or a receiver or receiver and manager under provincial law (other than in Québec where no such relief is possible under provincial law). This relief would typically be sought if:
  - a debtor is uncooperative; or
  - other factors require intervention by the court (for example, a dispute between secured creditors or between a secured creditor and other third parties).
- **Companies.** An interim receiver, receiver, or receiver and manager can be appointed in respect of a debtor in the circumstances described below, whether or not the debtor is insolvent or has committed an act of bankruptcy.
- **How, when and by whom.** The court can appoint an interim receiver under certain provisions in the BIA, where a secured creditor has given or is about to give notice that it intends to enforce its security and it is shown that such appointment is necessary to protect the debtor's estate or the interests of that secured creditor. A more limited type of interim receiver

can also be appointed at any time after the filing of a notice of intention to make a proposal or on the filing of a proposal, where it is shown that the appointment is necessary to protect the estate or the interests of one or more creditors. A receiver, or receiver and manager, can be appointed under provincial law where the court is satisfied that it is just or convenient to make the appointment. (A secured party can also appoint a receiver under a private instrument, where the security agreement provides for this remedy upon default. However, it is becoming increasingly uncommon for secured creditors to exercise private remedies in cases involving larger companies.)

- **Substantive tests.** See above, *How, when and by whom*.
- **How long.** There is no fixed duration for the appointment of a receiver. The appointment will generally continue until the court discharges the receiver.
- **Consents and approvals.** The court must approve the appointment of an interim receiver, receiver or receiver and manager. (This would not apply in the case of a private appointment pursuant to a security agreement.)
- **Effect.** The court appointed receiver derives its power and authority from the order of the court under which the appointment is made. Although the relief varies on a case-by-case basis, an appointment order typically provides for a stay of proceedings against the debtor and its property by third parties and prohibits the exercise of rights and remedies against the debtor or its property, except with leave of the court. It also typically provides that parties cannot terminate, repudiate, or interfere with contracts in favour of the debtor. The court appointed receiver will usually be authorised to sell and convey assets of the debtor within certain parameters and may also be authorised to operate the business of the debtor.
- **Conclusion.** A court appointed receiver typically applies for a discharge on the completion of its duties as set out in the appointment order.

#### Restructuring under a BIA proposal

- **Objective.** The objective of a proposal under the BIA is to reach a compromise with creditors and avoid bankruptcy. The procedure, which is similar to proceedings under the CCAA (*see below*), is primarily debtor-driven and is very roughly analogous to US Chapter 11 proceedings. Proposal proceedings are generally less costly and take less time to complete than proceedings under the CCAA. However, the rules and deadlines for BIA proposals are more rigid and the courts tend to exercise considerably less discretion than under the CCAA, which has very few procedural requirements.
- **Companies.** A proposal can be made in respect of an insolvent person (*see above, Bankruptcy*).
- **How, when and by whom.** A proposal can be made by an insolvent person, a receiver in respect of an insolvent per-

son's property, a bankrupt or a trustee of the estate of a bankrupt. Most frequently, it is an insolvent person who makes the proposal. A proposal must be made to all unsecured creditors and may also be made to secured creditors. The proposal process is initiated by filing either a notice of intention to make a proposal, or the proposal itself, with a licensed trustee in bankruptcy (known as the proposal trustee). The filing of a notice of intention effects an automatic 30-day stay of proceedings against all creditors (including secured creditors who have not yet begun enforcement proceedings) without the necessity of a court order, during which time the debtor can continue to operate its business.

- **Substantive tests.** Creditors have a right to apply for an order lifting the stay if, among other things, the debtor has not acted in good faith or with due diligence, if the debtor is not likely to be able to make a viable proposal, or if the creditors as a whole would be significantly prejudiced by the continuation of the stay. A creditor is also entitled to apply for an order that the stay does not apply in respect of that creditor, if it is likely to be materially prejudiced by the operation of the stay or there are other equitable grounds to lift the stay.
- **How long.** In the case of proceedings initiated by the filing of a notice of intention, the court can grant extensions to the time for filing the proposal and the stay of proceedings in increments of up to 45 days, to a maximum of five months after the initial 30 day period. If a proposal is not filed before the expiration of the stay period, the debtor is deemed to have made an assignment in bankruptcy.
- **Consents and approvals.** Within 21 days of the filing of a proposal, the proposal trustee must call a meeting of the debtor's creditors. The creditors vote by class on the proposal. Specific guidelines for the classification of secured creditors are contained in the BIA. Each class of unsecured creditors must vote for acceptance of the proposal by a majority in number and two-thirds in value of the claims voting. If the court then approves the accepted proposal, it is binding on the creditors.
- **Effect.** Once the terms of the proposal are fulfilled, the debtor corporation is discharged from the creditors' claims affected by the proposal. However, if the debtor defaults on any of its obligations under the proposal, the proposal can be judicially annulled and the debtor adjudged bankrupt. In addition to compromising the corporation's debts, a successful proposal may also compromise certain statutory claims against the corporation's directors, which relate to the obligations of the corporation for which the directors are by law liable in their capacity as directors.
- **Conclusion.** A debtor whose unsecured creditors refuse to approve its proposal is deemed to be bankrupt. Likewise, where a court refuses to approve the proposal, the debtor is deemed to be bankrupt.

#### Restructuring under the CCAA

- **Objective.** The CCAA was enacted to provide an insolvent corporation with a means of rearranging its affairs with both

its secured and unsecured creditors by making a compromise or arrangement with some or all of them and continuing to operate (as an alternative to liquidation). Although enacted during the 1930s, the CCAA was rarely used until the mid 1980s. It has now become the most important Canadian statute in the reorganisation of large corporate debtors primarily due to its flexibility, which allows for the exercise of considerable judicial discretion. In recent years, CCAA proceedings have also been used to facilitate the sale of all or a portion of the assets of the debtor company. Asset sales or liquidations can take place as part of, before, or, in many cases, without, the filing of a plan of arrangement, where the court is satisfied that the disposition is in the best interests of creditors and other stakeholders.

- **Companies.** The CCAA applies to insolvent corporations or corporate groups with debts of at least C\$5 million (about US\$4.3 million) and which are incorporated, carry on business or are resident in Canada.
- **How, when and by whom.** An initial application is made to the court for an order declaring that the debtor corporation is a corporation to which the CCAA applies and imposing a stay of proceedings to protect the corporation from its creditors while it formulates a plan of arrangement. Although possible, it is uncommon for CCAA proceedings to be initiated by a creditor.
- **Substantive tests.** In deciding whether to grant the initial application and order a stay of proceedings, the court will generally have regard to:
  - the likelihood that principal creditors will support the plan;
  - prejudice to the debtor in not granting a stay;
  - details of the proposed restructuring, to the extent then known;
  - public policy considerations, including the effect on employees and other stakeholders if the debtor ceases to carry on business or is liquidated; and
  - the ability of the debtor to maintain its business and operations.
- **How long.** Although the initial stay of proceedings cannot exceed 30 days, there is no limit on the length of an extension or series of extensions that can be granted in appropriate circumstances. While CCAA proceedings tend to last for six months to one year on average, there have been longer proceedings lasting up to two years or more.
- **Consents and approvals.** The court has discretion as to whether or not to grant the debtor's initial application and order a stay of proceedings. The plan of compromise or arrangement must be approved by a majority in number of the creditors (or each class of creditors) voting, representing two-thirds in value of the claims in each class. The CCAA does not contain specific rules on how to determine the

appropriate creditor classification, but the courts have established guidelines over the years based primarily on a "commonality of interests" test.

- **Effect.** In the initial application, the debtor corporation will generally request that all proceedings against it or its property be stayed until the holding of the meeting of creditors to consider the plan of arrangement. Where an initial order is made, the court must also appoint an official (known as a "Monitor") to monitor the business and financial affairs of the corporation during the stay period, and to report to the court and creditors. As in the case of BIA proposals, a plan of arrangement may compromise claims against directors of the debtor as well as the debtor itself.
- **Conclusion.** If approved by creditors, a plan of arrangement must be sanctioned by the court in order to be effective. Although rejection of a plan of compromise or arrangement under the CCAA does not automatically result in a debtor being adjudged bankrupt (as is the case where a proposal under the BIA is rejected), as a practical matter, a bankruptcy or receivership will frequently result in such circumstances.

## LIABILITY AND TRANSACTIONS

### 6. Are there any circumstances in which a director, parent company (domestic or foreign) or other party could be held liable for the debts of an insolvent company?

Personal liability of a director of a bankrupt corporation can arise in a number of circumstances, including the following (some of which do not relate to debts of the bankrupt corporation *per se*):

- Allegations that the director has breached his duties of care or good faith to the corporation.
- Allegations of misrepresentation and/or wrongful or oppressive conduct by directors.
- The corporation's non-payment of certain debts, including:
  - debts to employees for services rendered, including wages and current pension obligations; and
  - deductions at source required to be withheld in respect of federal and provincial sales and employee income taxes, employment insurance and pension contributions.
- Transactions entered into by the corporation while it was insolvent, or which made it insolvent, such as the issuance of dividends or the repurchase, redemption or acquisition of the corporation's shares.
- Offences under the BIA, as well as certain penal offences under other statutes.

Although such cases are not common, some examples where other parties could be held liable for the debts of a bankrupt corporation are:

- Shareholders, where there is cause to lift the "corporate veil" of limited liability in exceptional circumstances, such as cases involving fraud.
- Parties who manage or supervise the management of a corporation, for example, where all of the directors have resigned or have been removed by the shareholders without replacement, and such parties can be held liable to the same extent as if they were directors.
- In certain circumstances under applicable labour statutes, a "successor employer" who hires employees of a bankrupt corporation can be held liable for certain obligations in respect of those employees.

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#### 7. Can transactions that are effected by a company that subsequently becomes insolvent be set aside?

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A trustee appointed under a bankruptcy order or in respect of a proposal under the BIA can apply to court to set aside or obtain compensation in respect of certain types of transactions, including:

- Preferential payments or transactions, transfers or obligations incurred in favour of certain creditor(s), provided that:
  - the debtor was insolvent or was made insolvent as a result of the transaction;
  - the debtor had an intention to prefer the benefiting creditor; and
  - the preference was made, given, incurred, taken or suffered within three months (12 months, if to a related party) before the date of the initial bankruptcy event.
- Reviewable transactions, being those transactions where the consideration given or received by the bankrupt was conspicuously greater or less than the fair market value of the property or services involved.

Trustees and receivers can also use provincial fraudulent conveyances legislation to attack transactions entered into with the intent to defeat, defraud or delay creditors.

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#### 8. Please set out any conditions under which a company can continue to carry on business during insolvency or rescue proceedings? In particular:

- Who has the authority to supervise or carry on the company's business?
  - What restrictions apply?
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#### Bankruptcy

The assets of a bankrupt corporation vest in the trustee appointed under a bankruptcy order or voluntary assignment and, upon

bankruptcy, the directors of the corporation, and its shareholders, no longer have corporate authority to control the assets.

The trustee can carry on the business until the first meeting of creditors and, subsequently, with the approval of the inspectors.

#### Receivership

When appointing an interim receiver under the BIA or a receiver and manager under provincial law, the court can order that the receiver take possession of some or all of the property of a debtor in order to take conservatory measures and exercise such control over the business, as the court deems advisable. This may include carrying on the business of the debtor corporation. The powers of the directors are curtailed to the extent of the receiver's powers as set out in the court order.

#### BIA proposal

The directors continue to have legal control and responsibility for the business of the corporation, and the proposal trustee will not control or interfere with the day-to-day management of the business. However, it is possible to have an interim receiver appointed in the context of a proposal, in which case the interim receiver will have the powers provided for in the order under which it has been appointed.

#### CCAA proceedings

A corporation under the protection of a CCAA order operates as a debtor in possession with ongoing control over its assets and operation, subject to the oversight of the court-appointed Monitor and any restrictions imposed by the court. In some instances, a Monitor may be given expanded powers to assist the directors of the corporation in controlling the business in addition to its monitoring and reporting role. In addition, the court order may make provision for the appointment of a chief restructuring officer to have day-to-day management of the debtor's operations and/or the restructuring process.

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#### INTERNATIONAL CASES

#### 9. Please state whether:

- Courts in your jurisdiction recognise insolvency and rescue procedures in other jurisdictions.
  - Courts co-operate where there are concurrent proceedings in other jurisdictions.
  - There are any international treaties relating to insolvency to which your jurisdiction is a signatory.
  - There are any special procedures that apply to foreign creditors.
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- **Recognition.** Both the BIA and the CCAA contain provisions allowing foreign insolvency proceedings to be recognised. To

be effective against creditors and property in Canada, a foreign order must be recognised by a Canadian court. A "foreign representative", such as a bankruptcy trustee, liquidator, administrator or receiver, can initiate proceedings in Canada for recognition of foreign insolvency proceedings. Court recognition is discretionary and the principles of international comity are usually applied, unless Canadian public policy would be offended. For matters initiated in Canada, it is equally typical for a Canadian court to request the aid and recognition of its stay of proceedings and ancillary orders from foreign courts.

- **Concurrent proceedings.** The BIA and CCAA give significant discretion to courts to make orders that facilitate the coordination of Canadian and foreign "main" proceedings. Some of the principles applied include:
  - all stakeholders are to be treated equitably, and to the extent possible, similarly-situated creditors are to be treated equally regardless of their domicile;
  - enterprises should be permitted to draft restructuring plans that recognise their nature as a global unit and one jurisdiction should be permitted to assume administration of such restructuring;
  - there should be adequate communication between courts, as well as to stakeholders to permit their reasonable access to the primary jurisdiction dealing with the restructuring.

Courts in Canada and their counterparts in the US have established cross-border guidelines and protocols to facilitate procedural matters including court-to-court communications.

- **International treaties.** A variation of the UNCITRAL Model Law on Cross-Border Insolvency 1997 (UNCITRAL Model Law) may soon be adopted if and when the Insolvency Reform Act comes into force (*see Question 10*).
- **Special procedures for foreign creditors.** Foreign creditors are not treated differently from domestic creditors. Neither the BIA nor the CCAA create a separate category for foreign creditors, who enjoy the same rights as domestic creditors.

## PROPOSED REFORMS

### 10. Are there any proposals for reform to insolvency law in your jurisdiction?

Canadian insolvency law is undergoing major reform. On 25 November 2005, Canada's Parliament enacted the 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 (Insolvency Reform Act).

The Insolvency Reform Act will not come into force before 30 June 2006, ostensibly to permit Parliament's upper house, the Senate, to conduct a further detailed review of the legislation in light of its hastened passage by Canada's House of Commons in the final days of the last Parliament. Accordingly, the amendments discussed below have not yet come into force and may be subject to further amendments.

As currently enacted, among other notable changes to the BIA and CCAA, the Insolvency Reform Act codified certain rules applicable to debtor-in-possession (DIP) financing and permits the creation of new administrative charges. The act also addresses directors' liabilities and corporate governance in a restructuring context.

#### Wage-earner protection

Much of the impetus behind the Insolvency Reform Act related to a perceived need to provide better protections for employees in insolvencies. To that end, the Insolvency Reform Act introduces a newly created, government administered "Wage Earner Protection Program" which provides for priority claims for employees' unpaid wages up to an amount of C\$2,000 (about US\$1,723) each and a charge on the debtor's current assets to secure such claims. The Insolvency Reform Act also provides that current service pension shortfalls must be remedied in a CCAA plan or BIA proposal. Such claims are accorded a first ranking priority charge over all of the debtor's assets.

#### Other creditors' priorities over the debtor's assets

DIP financing has been a common feature in CCAA restructurings for a number of years, in spite of the fact that the CCAA contains no specific provisions to deal with it. The Insolvency Reform Act codifies certain rules relating to DIP financing under both the CCAA and the BIA, including the power to grant fresh security over a debtor's assets to a DIP lender.

#### Corporate governance

In respect of management of a restructuring debtor, the courts will be given discretion to remove and replace directors, based on a prospective consideration of whether they are "likely to unreasonably impair" a debtor's reorganisation, and to indemnify directors and officers against post-stay period personal liabilities through the creation of a super-priority charge against the corporation's assets.

The role and protection from liability of court-appointed officers, such as trustees and receivers, have also been clarified.

#### Restructurings

The Insolvency Reform Act clarifies the parameters of available relief for restructuring debtors and their stakeholders and codifies certain current practices by:

- Permitting a court to authorise asset sales out of the ordinary course of business and issue vesting orders.
- Addressing the disclaimer or assignment of certain executory contracts.

- Providing special rules for the treatment of aircraft lessors, including their ability to repossess "aircraft objects", similar to their treatment under the US Bankruptcy Code.
- Addressing claims and rights of equity holders in a debtor corporation, by expressly subordinating such claims to creditors' claims.

#### Reviewable transactions

Substantive changes are proposed to the rules applicable to reviewing and setting aside transactions. The key criterion will be whether a transaction was undertaken for consideration of less than fair market value. A trustee will be able to review transactions effected over the preceding one-year period with arm's length parties, and those effected over a period of up to five years where there are non-arm's length parties.

#### International cases: recognition and concurrent proceedings

The Insolvency Reform Act provides a framework for recognising foreign orders and regulating concurrent proceedings based on the UNCITRAL Model Law. The stated goals of the Insolvency Reform Act in respect of cross-border insolvencies are similar to those of Chapter 15 of the newly amended US Bankruptcy Code, which also adopted much of the UNCITRAL Model Law.

#### Concluding comment on insolvency reform in Canada

Whatever the final fate of the Insolvency Reform Act, the two main thrusts of recent insolvency law reform have been to make the BIA and CCAA more consistent, and to codify practices that have recently developed due to the courts exercising the considerable judicial discretion allowed under the CCAA.

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