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Canadian Corporate & Restructuring Legislation: Changes Could be on the Way

Bill C-97 (the "**Bill**") was introduced in Parliament to implement the federal budget tabled by the Liberal government on March 19, 2019. The Bill includes proposed changes to the *Canada Business Corporations Act* ("**CBCA**"), the *Bankruptcy and Insolvency Act* ("**BIA**") and the *Companies Creditors' Arrangements Act* ("**CCAA**"). One of the reasons for the proposed changes is to make insolvency proceedings more fair, transparent and accessible for workers and pensioners.[1] Changes targeted to that issue, and other proposed changes may have a noticeable impact on Canadian corporate and insolvency law if passed.[2]

With respect to the CCAA, the Bill would reduce the length of the initial stay of proceedings for companies that seek protection under that restructuring statute. The Bill would also limit the scope of relief that companies could obtain at the outset of a CCAA proceeding, and would impose a duty of good faith on all participants in Court-supervised insolvency cases. Courts would be given powers to reverse certain compensation paid to management in the year before a company's bankruptcy, and parties could apply to the Court to

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[1] *Investing in the Middle Class: Budget 2019*, p. 67.

[2] This bulletin discusses some of the proposed changes to Canadian corporate and insolvency statutes that are included in Bill C-97, which received its first reading in Parliament on April 12, 2019. This is not an exhaustive review of the bill's proposed changes, which include amendments to the *Bank Act* and the *Pension Benefits Standards Act* among other things.

obtain disclosure of the economic interests of other parties in a CCAA proceeding.

With respect to the CBCA, the Bill would see amendments to codify judge-made law on the scope of the fiduciary duty owed by directors and officers to their corporations, and explicitly permit management to consider the interests of workers and pensioners in fulfilling their corporate duties.

More particulars of the proposed changes and their implications are described below.

Changes to First Day Relief in CCAA Proceedings

The Bill would reduce the length of the initial stay of proceedings upon a company's application for CCAA protection from the current 30 days to ten days. It would also limit the relief that a company can obtain from the Court during the initial ten day period to "relief that is reasonably necessary for the continued operations of the debtor company in the ordinary course of business".

The proposed limits to the relief available to companies on the first day of a CCAA proceeding appear to be designed to curtail a common practice of requesting substantial relief from the Court with little or no notice to affected parties. For example, it is now common in CCAA proceedings for debtors to seek and obtain the approval of large DIP loans (interim financing), key employee retention plans, and even the approval of sale procedures on the initial application. However, the intended impact of the proposed changes might be undermined by the reality that substantial relief is often required at the outset of a CCAA proceeding to allow the debtor to continue its normal course operations. Initial orders in CCAA provisions are already often subject to a "comeback" provision, allowing affected parties to challenge the propriety of relief ten days after it is granted. Nonetheless, the Bill would likely impose greater discipline on the scope of relief that courts are willing to grant at the time that a CCAA application is approved.

A Duty of Good Faith

The Bill would amend the BIA and CCAA to require that all participants in insolvency proceedings "act in good faith", and give courts unfettered discretion to craft a remedy where this obligation is breached. Presumably, this could include the invalidation of a creditor's claim against a debtor's estate.

As currently drafted, the Bill does not provide guidance as to any specific requirements to meet the "good faith" standard. The concept of "good faith" exists in many areas of Canadian law and is notoriously imprecise. Part VII of the CBCA, entitled "Security Certificates, Registers and Transfer", defines "good faith," for that Part of the CBCA only, to mean "honesty in fact in the conduct of the transaction concerned".[3] In the performance of contracts, the Supreme Court of Canada has held that "good faith" is a broad "organizing principle" and specifically does *not* require a party to disclose material information to a counterparty.[4] This is probably not the same standard that is contemplated in the Bill for participants in insolvency proceedings.

Canadian courts have already recognized the duty of parties in a claims process to make "full disclosure"[5] or "full and frank disclosure"[6] of facts material to their claims against a debtor's estate. "Full and frank disclosure" is an extraordinary and exacting standard. It is imposed on parties in litigation who seek without-notice relief from the Court (i.e., *ex parte* relief). It requires a party to disclose all of the material facts that the absent party could be reasonably expected to have relied upon if they were present.[7]

The full and frank disclosure standard arguably puts claimants at a significant procedural disadvantage when they pursue their claims

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[3] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, Section 48(1), "good faith".

[4] *Bhasin v. Hrynew*, 2014 SCC 71 at 33 and 86.

[5] *I. Waxman & Sons Ltd., Re*, 2010 ONSC 2369 at 18.

[6] *Nortel Networks Corporation (Re)*, 2018 ONSC 278 at 125.

[7] *United States v. Friedland*, [1996] O.J. No. 4399 at 26.

within an insolvency proceeding as compared to the normal litigation process that would otherwise apply. Courts have routinely held that insolvency proceedings should not prejudice any creditor's rights.[8] An overly burdensome disclosure standard could incentivize more claimants to seek a "lift stay" (permission to pursue their claim in the normal course despite a stay of proceedings) rather than participate in a Court-ordered claims process. While it may not be Parliament's intention, the simple "good faith" requirement in the Bill could relax the heavy burden of "full and frank disclosure" that has developed in insolvency case law.

It remains to be seen whether the proposed duty of good faith will become law and whether it will be more thoroughly defined as the Bill moves through Parliament. As currently drafted, the proposed duty may well generate uncertainty and litigation over its scope and implications for participants in Canadian insolvency proceedings.

Disclosure of Economic Interests in CCAA Proceedings

The Bill would also amend Section 11 of the CCAA so as to promote transparency in a CCAA proceeding. The amendment would empower the Court, on application by any interested person, to order another party "to disclose any aspect of their economic interest" in the debtor. The party's "economic interest" would include a claim, eligible financial contract, or security interest, *as well as the consideration paid* for the interest.

In considering an application for such disclosure, the Court would consider the CCAA monitor's position on the proposed disclosure, whether disclosure would enhance the possibility of a successful compromise or arrangement, and material prejudice to any interested party. Interestingly, the prescribed factors for the Court's consideration do not include whether the disclosure is relevant to the merits of a party's claim against the estate. The proposed mechanism for compelling disclosure of economic interests would be

[8] *Redstone Investment Corp., Re*, 2015 ONSC 533 at 57.

a powerful tool potentially subject to tactical abuse by parties in CCAA proceedings.

Court Power to Reverse Management Compensation

The Bill would also amend Section 101 of the BIA. This section allows the Court to review dividends paid within one year of the company's bankruptcy to determine whether the company was insolvent at the time or was rendered insolvent by the dividend. The Bill would amend this provision to add termination pay and other benefits paid to managers of the company to the reviewable transactions. It would also give the Court the power to grant judgment against the managers in respect of such pay or benefits where certain requirements are met.

Stakeholder Interests and the Fiduciary Duty to CBCA Corporations

Last, the Bill would amend the CBCA to specify certain stakeholder interests that a director or officer may consider when exercising their fiduciary duty to the corporation they serve. The fiduciary duty requires directors and officers to act "honestly and in good faith in the best interest of the corporation".[9] This is different from the "*Revlon* duty" applicable in the United States, which emphasizes attention that directors and officers must pay to maximizing shareholder value to satisfy their fiduciary duty. In a series of decisions culminating in *Re BCE*, the Supreme Court of Canada held that the fiduciary duty under the CBCA is owed to the corporation itself, and that directors and officers *may* (but are not required to) consider the interests of various stakeholders of the corporation when exercising that duty.[10]

The Bill would amend the CBCA to specify that directors and officers *may* consider (a) the interests of stakeholders such as shareholders, employees, <u>retirees and pensioners</u>, creditors, consumers and governments, (b) the environment and (c) the long-term interests of

[9] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, Section 122(b).

[10] *BCE Inc., Re*, 2008 SCC 69 at 39-40.

the corporation. Parts (a) and (b) of this list repeat the same examples of interests that the Supreme Court of Canada identified in *Re BCE*, but explicitly adds the interests of retirees and pensioners. The explicit addition of retirees and pensioners to the list in the statute may cause the directors and officers of troubled CBCA companies to give greater consideration to the implications of an insolvency proceeding for these stakeholders, and doing so will offer management some protection when exercising their powers with those interests in mind.

The addition of "the long-term interests of the corporation" to the list of stakeholder interests that officers and directors *may* consider is peculiar. In *Re BCE*, the Supreme Court of Canada held that when a corporation is an ongoing concern, the fiduciary duty "looks to the long-term interest of the corporation".[11] The Court then listed stakeholder interests that management *may* consider, "although *not mandatory*", including the interests of shareholders, employees, creditors, consumers, governments and the environment.[12] By folding the very object of the fiduciary duty – the long-term interests of the corporation – into the list of non-mandatory stakeholder interests that a director or officer *may* consider, the Bill could unintentionally reformulate the fiduciary duty that the Supreme Court of Canada articulated in the case law culminating in *Re BCE*.

[11] *BCE Inc., Re*, 2008 SCC 69 at 39.

[12] *BCE Inc., Re*, 2008 SCC 69 at 40.

Conclusion

The Bill is intended to add transparency and fairness to Canada's corporate and insolvency regimes. Many of the proposed changes to the BIA, CCAA and CBCA are an effort to codify recent developments in Canadian case law. However, the Bill would also bring significant changes to the substantive and procedural rights of corporations' stakeholders, especially in insolvency situations. As it is currently drafted, the Bill would introduce much uncertainty to Canada's principal corporate and insolvency statutes. The commercial and insolvency bar in Canada will be watching closely as the Bill evolves and gets closer to being law.

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