

Insolvency & Corporate Restructuring

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Options to Deal with Insolvency

One of the most difficult decisions that your client can make is to seek professional help to deal with financial difficulties. Once that decision is made, what are the options? There are various options available under the *Bankruptcy and Insolvency Act* (the “**BIA**”) and the *Companies’ Creditors Arrangement Act* (the “**CCAA**”) to restructure a business’ debt in order to save a failing business.

Generally there are four formal options available to restructure:

1. a bankruptcy under the BIA;
2. a receivership under the BIA;
3. a proposal under the BIA; or
4. a restructuring under the CCAA.

1. Bankruptcy

In a bankruptcy, all of the assets of a company vest in, and are sold by, a Trustee in Bankruptcy with the proceeds paid to creditors. This means the business owner loses control of the business. The Trustee’s ultimate focus is to maximize recovery for creditors.

How can a bankruptcy be used to restructure a business? The Trustee will sell the assets of the business to the highest bidder. The owner will often be in the best position to know what the maximum value of the assets is and to bid that amount. If the bid is successful, the owner purchases the assets of the business but is not subject to the unsecured liabilities of the business.

There are two primary disadvantages to using a bankruptcy to restructure. First, the bankruptcy only affects unsecured creditors. Secured creditors (such as creditors who register pursuant to the *Personal Property Security Act* or creditors who hold mortgages) cannot be compromised in a bankruptcy. Second, the owner loses control of the process and the business. The Trustee selects the winning bid, which may not be the bid submitted by the owner.

A bankruptcy can be used effectively where there is no secured debt or where the business owner will have to pay the secured debt in any event.

2. Receivership

A receivership is primarily used by secured creditors to enforce on security. However, in limited circumstances it can also be used by a business to restructure. Like a bankruptcy, in a receivership, the Receiver takes control of the business, runs a

sale process and finds a purchaser for the assets of the business.

Only secured creditors can appoint a receiver under the BIA. The business owner has to be a secured creditor by securing advances into the business or purchasing existing secured debt.

The business owner can bid on the assets of the business and, if successful, can buy the assets free and clear of all encumbrances (such as security interests, liens, executions, etc.).

The receivership solves the first of the two problems with the bankruptcy – compromising secured creditors – but it does not solve the second – losing control of the process. The Receiver will select the winning bid and the business owner has no control over the selection process.

3. Proposal under the BIA

Unlike a bankruptcy which is designed to liquidate the assets of a failed business or a receivership which is designed to allow secured creditors to enforce on security, a proposal is designed to be used by a business to restructure its debt and to continue operating. The primary purpose of a proposal is to make an offer to creditors, called the Proposal, which will be voted on by the creditors.

In a proposal, the owner remains in control of the business and in possession of the assets while working on the Proposal. In this process, a Proposal Trustee is appointed to monitor the business and to report to the creditors which gives the creditors comfort that the assets are secure.

The process is started by filing a Proposal or, more commonly, by filing a Notice of Intention to Make a Proposal (the “**Notice of Intention**”). Filing a Proposal or a Notice of Intention prevents all creditors, including secured creditors, from taking any steps to collect for 45 days. During this period creditors cannot sue, cannot take steps to enforce judgments, and cannot enforce on security.

A Proposal is subject to strict time limitations. While working on its Proposal, the business can go back to court to ask for

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further 30 day extensions of the initial 45 days, to a maximum of six months.

Once the company completes its Proposal, the creditors vote on it and it must be approved by the court. If the Proposal is accepted by the creditors and approved by the court then it can be binding on all creditors.

A Proposal can have terms that:

- compromise certain claims against directors;
- allow for financing ranking ahead of secured creditors;
- prevent third parties from terminating contracts for non-payments prior to filing; and
- terminate undesirable agreements such as commercial leases for real estate.

One disadvantage of a Proposal is that if it is not accepted by creditors or not approved by the court, the business is automatically deemed to make an assignment in bankruptcy.

Even with these limitations, the proposal is often the best option for anything other than the largest business.

4. Restructuring under the CCAA

The majority of restructuring proceedings that become newsworthy, such as Air Canada, Stelco, or, recently, Target, are completed under the CCAA. A restructuring under the CCAA is similar to a proposal in that the owner of the business remains in possession of the business with a court appointed Monitor monitoring the business to protect the interests of creditors, however the CCAA is limited to companies with debts exceeding \$5 million. Companies with debts below \$5 million can only use the three other processes set out above, and primarily the Proposal process.

Like with a Proposal, the aim of a CCAA restructuring is to restructure the company with a view to it becoming viable. The biggest difference between a proposal under the BIA and a restructuring under the CCAA is that the CCAA process is much more customizable but much more expensive, whereas the Proposal is a much more structured process at a significantly lower cost.

Recognizing that a business is in financial distress at an early stage and then addressing the financial distress quickly with the appropriate mechanism are key to ensuring the continued success of a business.

Pallett Valo LLP Insolvency & Corporate Restructuring Practice

We provide legal advice to debtors, secured and unsecured creditors, trustees and receivers in the context of proceedings under the "Bankruptcy & Insolvency Act" (BIA) and the "Companies Creditors Arrangement Act" (CCAA). Over the course of the last several years, we have guided lenders, suppliers and landlords through numerous significant CCAA proceedings.

The lawyers in our Insolvency & Corporate Restructuring Practice regularly appear in Commercial Court in Toronto and are frequently involved in litigation and other proceedings under the BIA and related provincial legislation, for the recovery of assets and setting aside of fraudulent transactions. We have proven our ability to recover assets even in the most difficult of circumstances. On the commercial side, we assist clients and Trustees/Receivers in the restructuring process, as well as the purchase and sale of businesses and assets in transactions involving insolvent entities.

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This article provides information of a general nature only and should not be relied upon as professional advice in any particular context. Contact a member of our **Insolvency & Corporate Restructuring Practice** at **905.273.3300** for more information.

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