

## Insolvency Bulletin

June 2007

### The Insolvency Proposal: An Alternative to Bankruptcy

More businesses and individuals declare bankruptcy than is really necessary. If done in time, a meeting with insolvency counsel can result in making a Proposal to creditors instead.

#### **The Bankruptcy and Insolvency Act**

For a company or individual in dire financial straits sometimes the only path that seems open to them is to declare bankruptcy. But there are other, more attractive options that will allow them to carry on. The *Bankruptcy and Insolvency Act* provides a straightforward procedure for a company or an individual to avoid bankruptcy by filing a Proposal, a process clearly more beneficial from all perspectives, (including that of the creditors, since by law Proposals must offer more than they would receive in a bankruptcy).

#### **Give Yourself Breathing Space**

The purpose of a Proposal is to allow an honest but unfortunate debtor to pay his creditors to the best of the debtor's ability, under the supervision of a Trustee, and to provide for a fair distribution of the debtor's payments among creditors. Once a Notice of Intention to file a Proposal is sent, all court actions or collection proceedings underway by creditors cannot be proceeded with. The benefit of stopping creditors from pursuing or harassing the debtor is significant, and allows a period of calm to assess the full situation.

#### **Negotiate with Creditors**

If approved, the Proposal is a binding contract, for the debtor and all the creditors who support it, and any minority of unsecured creditors who had been unwilling to accept it. The advantages of making a Proposal include avoiding the stigma (and asset value erosion) of bankruptcy and the risk of losing all assets or having an ongoing business shut down. Proposals can even be used to stave off a bankruptcy process which has already been started. However, a Proposal will not succeed if the debtor can't offer creditors enough to satisfy them that they are getting more than they would get in a bankruptcy.

The more common types of Proposal include:

1. the "Cash Settlement Proposal", which provides a payout of a given percentage of the outstanding claims, either as a lump sum or over time, (though creditors usually prefer to receive a lump sum payment up front); and
2. the "Liquidation Proposal", which provides for the orderly liquidation and sale of the assets of a business (often to a new start-up entity), with the realization then being shared among its creditors.

Creditors vote on a Proposal by letter, or in person at a creditors meeting held approximately 3-4 weeks after a proposal is filed. The Trustee supervising the Proposal must file a report to the creditors on the affairs of the debtor and the causes of the financial difficulties. The Trustee must also present to the creditors his/her estimate of what the creditors would receive in a bankruptcy as opposed to what they are being offered under the Proposal. The Proposal requires approval by the majority of those creditors who vote, representing two thirds in value of all their claims. The Proposal must then be approved by the Court. If the Proposal does not receive the required votes or the Court refuses to approve it (which is rare if the Proposal has been approved by creditors), then there is an automatic deemed bankruptcy.

If the Proposal is approved, the debtor will enjoy its benefits so long as all its terms are complete and carried out as promised. If they are, the debtor will have no further obligations to those creditors. However, if at any time the debtor defaults in the performance of a Proposal obligation, it is open to the Trustee or creditors to apply to the Court for an order that the Proposal be annulled, which will result in a deemed bankruptcy.

## Create a Win-Win Scenario

Preparing a Proposal for individual professionals, (e.g. doctors or business people), usually involves dealing with large debts to the government for non-reporting of tax obligations. For a business, the goal is usually to restructure as a going concern. The client, insolvency lawyer and the Trustee will work through what can be offered to the creditors, draft a Proposal that presents a win-

win situation for the debtor, and the creditors and steer the debtor through all required filings, the approval steps and the completion of the Proposal.

The insolvency specialists at Pallett Valo LLP have completed many successful Proposals for both individuals and businesses. We have the right experience and expertise to assist in preparing and getting approval of a Proposal to resolve your business or personal financial dilemma.

## Pallett Valo LLP Insolvency and Corporate Restructuring Law Group:

The lawyers in our Insolvency & Corporate Restructuring Group 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.

### Areas of Practice Include:

- Advising on BIA Proceedings
- Asset Recovery
- Corporate Restructuring
- Creditor/Debtor Rights
- Mortgage Remedies
- Priority Disputes
- Advising on CCAA Proceedings
- Commercial Receiverships
- Corporate Bankruptcy Petitions
- Fraudulent Transactions
- Personal Bankruptcy Petitions
- Secured & Unsecured Transactions

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The purpose of this document is to provide information as to recent developments in the law. It does not contain a full analysis of the law nor does it constitute an opinion of Pallett Valo LLP or any member of the Firm on the points of law discussed.

If you would like additional copies of the bulletin, or know of anyone who would be interested in joining our mailing list, please contact **Jenny Chiu** at [jchiu@pallettvalo.com](mailto:jchiu@pallettvalo.com).