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Insolvency and Restructuring Bulletin

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September 18, 2009 – Canada's Insolvency Reforms in Force

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In 2005, Parliament passed a comprehensive package of reforms to Canadian insolvency and restructuring laws. The purpose of these amendments was to provide additional protections for employees, codify existing case law and practice, bolster the proposal process and conform Canadian laws concerning cross-border insolvencies to international practice.

The 2005 amendments were not immediately proclaimed in force in order to allow time to fine tune some of the provisions. As a result, extensive amendments to the amendments were enacted in 2007; however, the reform package was still not proclaimed in force. In July 2008, a limited number of the provisions - dealing mainly with employee protections - took effect. Finally, the balance of the amendments will be proclaimed in force effective September 18, 2009.

Insolvency law in Canada falls within the federal domain. The *Bankruptcy and Insolvency Act* (the "BIA") contains provisions dealing with the restructuring of debtors through "proposals" (usually used for individuals or less complex restructurings) or the "bankruptcy" (a liquidation and distribution process) of debtors. The *Companies' Creditors Arrangement Act* ("CCAA") contains flexible provisions that normally are used for restructuring more complex enterprises. The reform package contains amendments to both the BIA and the CCAA. The following are some of the more material amendments.

1. Unpaid Wages – The *Wage Earners Protection Program Act* (the "WEPP") is part of the reforms enacted in July 2008 to protect employees. The WEPP provides for payment of up to $3,000 per worker for wage and vacation pay arrears as well as severance and termination pay by the federal government. The federal government is subrogated into the workers' rights as against the employer and directors.

In addition, since July 2008, workers are protected under the BIA by a super-priority charge of up to $2,000 per worker for arrears of wages and vacation pay secured on the current assets of a debtor. On September 18, 2009, the CCAA will be amended to provide that a plan of arrangement can only be approved by the court, if wage and vacation pay arrears are satisfied.

2. Unpaid Pension Contributions – Since July 2008, workers have benefited from a statutory super-priority security interest, created to protect unpaid normal

pension contributions (not including "special payments" or deficiency claims) in the context of bankruptcies and receiverships. This security interest forms a super priority charge over all assets of the debtor.

As with unpaid wages, in September 2009, unpaid pension contributions will also become a factor in restructurings. The amendments require that BIA proposal or CCAA plan may only be approved by the court if certain pension contributions are satisfied.

Undoubtedly, the security interests created with respect to arrears of remuneration and normal pension contributions will cause considerable concern to lenders as these liabilities are difficult to quantify and rank in priority to private security agreements.

3. Collective Agreements – Unlike the position under the U.S. Bankruptcy Code, the amendments essentially provide that a collective agreement cannot be revised without the agreement of the union.

4. Treatment of Executory Contracts – The rules with respect to disclaimer and assignment of executory, non-real property, contracts have been clarified. Contrary to existing law, executory non-real property contracts can now be assigned in certain circumstances despite contractual bars on assignment. Also, the rights of licensees of intellectual property are now protected.

5. Interim Financing – The ability to obtain secured, interim financing (DIP lending) in a restructuring (both under the BIA proposal provisions and under the CCAA) has been codified and the criteria for the court ordering such financing have been formalized, including notice on affected secured creditors. One element of the codification of DIP financing that may prove important is that the related security cannot secure pre-filing debt.

6. Receivers and Receivership Proceedings – The anomaly whereby "interim receivers" appointed under the provisions of the BIA acted as full-blown receivers has been addressed. Interim receivers will now truly be "interim." A new federal receivership regime has been created for other circumstances, although the powers of such a receiver are not clear.

7. Sale of Assets – Practice under the CCAA permits sales of assets out of the ordinary course during the restructuring. This has not been permitted in BIA restructurings. The amendments permit sales of assets out of the ordinary course under both regimes and set out the parameters for obtaining court approval of such sales. There are special rules with respect to sales to "related persons". The law with respect to granting vesting orders has now been codified as well.

8. Governance Issues – The court has now been granted the power, under both restructuring regimes, to remove a director who is unreasonably impairing the possibility of a viable reorganization or is likely to act inappropriately as a director. The courts have not been provided with any criteria on which to assess such conduct.

9. Judicial Charges – In addition to granting a judicial charge to secure interim financing (DIP loans), a practice has grown in restructurings under the CCAA for the court to grant charges to secure certain professional fees and, so-called "Directors Charges" to secure court-ordered indemnities of directors who remain on board during the restructuring. These charges have now been codified and have been extended to restructurings under the BIA. The criteria for granting such charges are now specifically set out, including notice on affected secured creditors.

10. Critical Suppliers – Significant confusion and inconsistency has surrounded the treatment of critical suppliers. The amendments to the CCAA now provide for the designation of a supplier as a

"critical supplier" by the court. If such designation is made, the critical supplier is obliged to continue to supply on terms and conditions consistent with its pre-filing relationship with the debtor. The critical supplier is to be granted a judicial charge to secure payment for the goods or services provided. Curiously, no parallel provision has been created with respect to a restructuring under the BIA.

11. Transfers at Undervalue – The existing confusing rules with respect to "settlements" and "reviewable transactions" are removed in favour of provisions dealing with any "transfer at undervalue." Any transaction with a debtor having a consideration conspicuously less than the fair market value of the property or service sold is subject to review. The time parameter for the review varies depending upon whether or not the counterparty was at arm's length. The remedy can be a monetary judgment for the delta between fair market value and the amount actually paid or received.

12. Subordination of Equity Claims – The law in this area has been clarified. Claims related to rescission of or a misrepresentation related to a purchase and sale of a share or unit of the debtor will be subordinated to claims of creditors.

13. Inclusion of Income Trusts – Both restructuring regimes have been modernized in order to provide for the restructuring of income trusts that have assets in Canada and units that are traded on a prescribed stock exchange.

14. Cross-Border Insolvency Provisions – the existing provisions under the BIA and CCAA are repealed and replaced by comprehensive provisions based upon the United Nations Commission on International Trade Law Model Law (though the UNCITRAL model law has not been expressly adopted). The revisions are intended to promote co-operation in cross-border insolvency proceedings by authorizing the courts to co-ordinate and co-operate with each other, by restricting the scope of local (Canadian) insolvency proceedings when foreign main proceedings have been commenced and by granting relief to representatives of foreign proceedings. The provisions are similar to those of Chapter 15 of the U.S. Bankruptcy Code.

15. Other Amendments – Numerous technical amendments have been made to the BIA and CCAA. These amendments include changes with respect to unpaid suppliers' rights and the status of registered retirement savings plans and income funds.

Going Forward

The amendments make substantial changes to Canadian insolvency and restructuring laws. The changes may have a significant impact on lending practices in view of the creation of various super priority charges, as well as on the use of BIA proposals as vehicles for restructurings. Only time will demonstrate the full impact of these changes.

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