

**RECOVERY, INSOLVENCY, BANKRUPTCY
& ARRANGEMENTS IN CANADA**

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I. RECOVERY PROCEEDINGS IN CANADA

(a) The Governing Courts

The Canadian civil courts system is divided into two distinct branches.

The Federal Court system includes the Federal Court of Canada and the Federal Court of Appeal. The jurisdiction of these Courts is limited to matters exclusively under the jurisdiction of the Federal Government and, as such, is very limited in the scope of its jurisdiction. The primary matters contained in the Federal Court system deal with matters of patent or other intellectual property disputes, maritime issues and claims as against the government. The Federal Court has virtually no involvement in matters involving recovery disputes.

The high courts in each of the provinces deal with almost all civil and commercial disputes. In Alberta, the governing Court is the Alberta Court of Queen's Bench. Appeals from any Court of Queen's Bench decision can proceed, in most cases, as an automatic right, to the Alberta Court of Appeal. The Alberta Court of Queen's Bench sits in approximately twenty judicial centres throughout Alberta with its primary Court Houses being located in Calgary and Edmonton. The Alberta Court of Appeal holds hearings in Calgary and Edmonton only.

Any appeal from the Alberta Court of Court of Appeal could be heard only by the Supreme Court of Canada. Currently the Supreme Court hears appeals only in Ottawa, Ontario but that Court is considering hearing certain motions via television conference to reduce costs and travel. The Supreme Court of Canada limits the appeals it is willing to hear requiring the Appellant to show that the appeal is a matter of national interest and is effectively limited to Charter appeals or civil appeals involving an issue of an emerging argument or trend. The restricted appeal practice of the Supreme Court of Canada has effectively resulted in the Alberta and other provinces' Courts of Appeal being the final level of appeal for any commercial dispute.

Actions are commenced in the Court of Queen's Bench by the filing of a Statement of Claim or, in limited circumstances, an Originating Notice. Virtually all recovery proceedings would be commenced by the issuance of a Statement of Claim. In Alberta, a Plaintiff, except in unique circumstances, has two years from the date the cause of action arose to commence an action.

Most preliminary matters in a lawsuit, including the appointment of a Receiver, Orders for removal and sale of secured or unsecured assets, declarations and summary judgment are heard by the Court of Queen's Bench at a Chambers hearing. No *viva voce* evidence is allowed at a Chambers hearing and the application must be based solely upon Affidavit evidence or transcripts arising from Examinations under oath of the deponents of Affidavits. Most Chambers applications in Calgary can be scheduled on a few days notice or, in emergency situations, *ex parte* without notice to the other party.

Civil procedure in the province of Alberta is governed by the Alberta Rules of Court. Certain Chambers applications identified in the Rules of Court can be heard before a Master of the Court of Queen's Bench. An appeal from the decision of the Master would be heard by a Justice of the Court of Queen's Bench. An appeal from a Justice of the Court of Queen's Bench, in cases both where the Justice has made an original Order or the Justice has made a finding by way of an appeal from a Master, would be heard by the Alberta Court of Appeal.

Masters and Justices of the Court of Queen's Bench sit alone when hearing applications. The Alberta Court of Appeal generally sits in a panel of three.

All trials requiring *viva voce* witness evidence are heard before Justices of the Court of Queen's Bench.

Appeals before the Alberta Court of Appeal are based solely upon the transcript evidence that was before the Trial Justice and no witnesses are allowed.

It generally takes 2 or 3 years between the filing of a Statement of Claim and the conduct of a trial in Calgary. On average, approximately 1 year will pass from the time of a trial judgment until an appeal would be heard by the Alberta Court of Appeal.

(b) [Recovery Practice](#)

Prior to filing any Court proceedings, the usual practice in Alberta is to demand payment of the amount outstanding.

Preliminary matters to be considered by the creditor would include a consideration as to whether there is a *bona fide* dispute or simply an inability or unwillingness to pay. Information can be obtained from various public registries including the Court House (action searches), the Official Receiver (bankruptcy searches) and the Personal Property Registry (personal property searches). In addition, various private firms can obtain background, bank account and other financial information concerning any debtor.

With this additional information, an informed decision concerning a settlement proposal, a negotiated payment schedule or the necessity to file proceedings can be made.

Creditors should be aware of notice requirements when deciding how to proceed against a debtor. Section 244(1) of the Canada *Bankruptcy and Insolvency Act* ("*BIA*") requires that at least 10 days notice be provided in the form set out under that Act where a secured creditor is intending to enforce its security as against all, or substantially all, of the debtor's inventory, accounts receivable or other property. This notice under section 244(1) can be waived by the debtor after, but not before, the notice has been given.

Similarly, at common law in Canada, a lender must provide a reasonable opportunity to a debtor to respond to a demand for payment. The length of this common law notice would be set by the Court on a case by case basis looking at numerous variables including the amount of the indebtedness, the possible insolvency of the debtor and the particulars of any default that might have occurred under the loan agreement. In various cases where the lender could show no urgency to the Courts, a time period of much greater than 10 days had been ordered. Of course, such additional notice would only be warranted in circumstances where there is no concern that the secured collateral could be dissipated or deteriorate. The Alberta Courts have not yet definitively determined whether the 10 days notice period under the *BIA* replaces this common law notice requirement. As such, in appropriate circumstances, the lender should consider providing a 21 or 30 day written notice to the debtor in conjunction with the 10 day *BIA* notice to avoid potential future arguments. Failure to comply with notice requirements at common law may result in liability by the creditor for the debtor's losses caused by the insufficient notice: *Haggart Construction Ltd. v. Canadian Imperial Bank of Commerce*, [1998] A.J. No. 20 (QL).

In extreme circumstances, an application may be brought before the Courts to shorten the required notice period under the *BIA*. This will only be allowed by the Courts in extreme circumstances such as instances where the debtor has abandoned its business and the secured collateral is subject to immediate and extreme deterioration. Further, upon application to the court by the secured creditor, an interim receiver may be appointed to protect the assets during the notice period. If extraordinary circumstances exist, prejudgment attachment orders to preserve the debtor's assets prior to trial may also be obtained by way of a Court Order.

Overall, once demand has been made, the fastest and least expensive realization would involve the debtor delivering or quit claiming the secured assets to the lender. If the lender would agree to a quit claim of the secured assets, searches at the appropriate registries would have to be undertaken to ensure the ability of the debtor and lender to extra-judicially deal with the assets in that regard.

Assuming that the debtor and creditor are unable to reach an agreement, or in instances where the debtor is unable to cooperate, there are several recovery alternatives that may be pursued:

(i) [Action for Debt](#)

In addition to or in conjunction with the enforcement of the lender's security as against the debtor's collateral, an action for recovery of any deficiency that might arise is also usually filed. Once all of the secured collateral has been recovered, a judgment for the deficiency amount may be sought. The judgment results in an unsecured claim that may be pursued by the lender as against any assets of the debtor that might not have been included as collateral under its security agreement. In instances where the lender has a floating charge as against all of the assets of the debtor, then

such a judgment is usually without value unless third party guarantees had been provided in which case those guarantors should also be included as Defendants in the debt action.

Once a claim is served upon a Defendant in Alberta, the Defendant will have 15 days to file a Defence. If service must be completed outside of Alberta, an Order allowing service must be obtained with the time to respond being set by the Court in its discretion.

If no Defence is filed, the Plaintiff can file a Default Judgment and then take steps to enforce that Judgment.

If a Defence is filed, the Plaintiff has to take steps to obtain a Summary Judgment or, if matters are in dispute, a Judgment following trial.

In cases where it can be established through Affidavits that there is no genuine issue to be tried (such as cases based on Promissory Notes, acknowledged debts or delivered supplies with no issue as to quantity or quality), the Plaintiff can apply for an order for Summary Judgment. The Court considers the application based only upon Affidavits, transcripts or any examination on Affidavits and attached documents. If the Court finds a triable issue exists, the application will be refused and the matter ordered to proceed to trial.

If not settled, most cases require a trial of an action. Prior to the trial, the parties must exchange lists of all relevant documents. This listing, known as an Affidavit of Records, must contain all relevant documents whether they aid or hinder a party's case. Only certain privileged documents (such as solicitor-client correspondence) are exempt from production.

Representatives of each corporation are then produced to be examined in oral Examinations for Discovery (depositions). There is no established practice in Alberta similar to the American practice to exchange written interrogatories and discovery examinations are more closely limited to the litigants in the dispute and does not extend to third parties witnesses.

Once the production of documents, Examinations for Discovery and all other pre-trial matters have been concluded, the parties file a Certificate of Readiness and set the matter down for trial.

The trial will proceed before a Justice of the Court of Queen's Bench with most evidence being presented through live, sworn witnesses.

The Alberta Rules of Court provide that the successful party will usually recover costs and disbursements as set out in a published tariff schedule. These taxable costs represent only a portion of actual solicitor costs but can accumulate to a significant sum in lengthy disputed proceedings. Also, a successful party can recover full indemnity solicitor-client costs if such recovery is

specifically included in the governing agreement or credit application.

Once a Judgment is obtained, the successful judgment creditor can enforce its Judgment through the following:

1. seizure of assets;
2. garnishment of bank accounts or receivables;
3. registration at the Personal Property Registry;
4. examination of the debtor under oath for particulars of their assets;
5. requirement of the debtor to complete a Statutory Declaration disclosing assets.

(ii) [Seizure and sale of goods by a secured creditor or judgment creditor](#)

Before Judgment, this option relates only to assets of the debtor (other than real property) that are located within Alberta and are subject to a creditor's security. It includes any pledge of assets to secure payment obligations. This option also applies after Judgment, once a writ of enforcement has been issued and registered in the Personal Property Registry.

The procedure governing seizure and sale of a debtor's assets was substantially altered with the enactment of the *Civil Enforcement Act*. Currently in Alberta, a seizure may be conducted only by a civil enforcement agency. The lender is not entitled to directly seize secured assets through any extra-judicial process.

When seizing pursuant to a security agreement, the bailiff may effect the seizure by: taking physical possession of the property; giving a notice of seizure to the debtor or person in possession of the goods; or, posting a notice of seizure where the goods are stored.

Once this has been accomplished, the goods are legally controlled by the bailiff (either by physical removal or by leaving the goods with the debtor or another party with an undertaking not to remove or dispose of the goods) with notice of the seizure being given to the debtor and all other interested parties, including all potentially competing debtors. This notice provides either for the sale of the collateral to reduce the indebtedness owing or, at the lender's discretion, a foreclosure and retention of the seized assets in full satisfaction of the indebtedness. Obviously, such a foreclosure will occur only when the lender anticipates that the seized assets are sufficient to fully satisfy the outstanding indebtedness or in instances where the lender has concluded that no other assets would be available for a recovery of any deficiency that might arise.

The debtor or other interested parties will have 20 days from the date of notice to either file an objection to the proposed sale or foreclosure or to satisfy any outstanding payments to bring the loan agreement back into good standing. If a written objection to the proposed sale or foreclosure is

received, the lender must make a Court application for further directions and a determination as to the outstanding indebtedness.

Special seizure rules apply to certain assets such as shareholding interests.

(iii) [Foreclosure or Sale of Real Property](#)

The following discussion applies only to corporate debtors. Individual borrowers who have pledged real estate as security in Alberta have significantly additional rights and protections that would delay or preclude portions of the foreclosure process.

The provisions of the *Law of Property Act* require that foreclosure or vesting rights be enforced through Court proceedings. A secured lender may not be able to force a transfer of secured real property notwithstanding any such rights that may be incorporated in the security documentation.

To enforce security as against lands, an action should be commenced by Statement of Claim in the Court of Queen's Bench. The debtor and any other party who has a registered ownership interest should be named as Defendants in this action.

Where the property is producing revenue (such as an oil and gas property or a commercial property with tenants) the Courts will often allow an application for the appointment of an interim Receiver of the property to protect the property and receive the revenues from the property pending completion of the foreclosure process.

After service of the Statement of Claim, the lender usually proceeds to file a Default Judgment (if no Statement of Defence is filed within 15 days) or obtain an Order for Summary Judgment if a Defence is filed. A Chambers application is then scheduled for the Court to set a redemption period, if any, to be allowed for the debtor corporation to bring the Mortgage into good standing.

The lender must then file with the Court an Affidavit of Default setting out the amounts outstanding under the Mortgage agreement and an Affidavit of Value prepared by a qualified appraiser establishing the value of the secured real property collateral.

If there is no equity in the property, the lender may wish to apply to the Court for an immediate Order for Foreclosure. If a final Order for Foreclosure is obtained, the secured lender is deemed to have accepted the transfer of the secured property in full satisfaction of the indebtedness and the lender may not attempt to recover any deficiency that may arise.

Alternatively, the Court may allow for the sale of the property to the lender for a price to be established by the Court having reference to the values set out in the appraisal report. Such a

practice is commonly referred to as obtaining a "Rice Order". If such an Order is granted, the property is transferred to the lender (Plaintiff) and the lender's right to sue the debtor for any deficiency survives.

Where there is equity in the property, or in instances where the lender does not want to acquire title to the secured property, the Court can order the sale of the property by way of an advertising and tender process or through a judicial listing. Under either process, the Court will review any proposed purchase in conjunction with the secured lender. If a third party Offer to Purchase is acceptable to the lender and the Court, then that sale will proceed with the monies being paid in accordance with the secured registrations appearing on title. The lender will be entitled to bring a claim as against the debtor for any deficiency that might arise and would be obliged to account to the debtor for any surplus sales proceeds.

If no acceptable tender or Offer to Purchase is received, the secured lender can either apply to extend the sales process or can bring an application for a Foreclosure or Rice Order.

Under any of the above scenarios, the purchaser (or lender if a Foreclosure is obtained) takes the secured real property subject to any prior encumbrance registered on title but all subsequent encumbrances are removed or deleted.

Note, secured creditors should be aware that the *Farm Debt Mediation Act* extends special protection (e.g. additional notice requirements) to persons engaged in farming for commercial purposes, which affect both real and personal property.

(iv) [Receivership](#)

A Receiver, or Receiver-Manager, may be appointed either through Court process or privately.

By strict definition, a Receiver is entitled only to take possession of the debtor's assets and arrange for their sale. A Receiver-Manager, however, is entitled to take control of the debtor's assets and arrange for their sale or, alternatively, carry on the debtor's business indefinitely pending a sale of the assets either as a going concern or on a piecemeal basis.

In Alberta, the lender's security documentation usually includes the right to appoint either a Receiver or Receiver-Manager. Because of the extra flexibility provided to a Receiver-Manager it is usual that a Receiver-Manager and not merely a Receiver be appointed. Because the practice has developed that Receiver-Managers are almost always appointed, Receiver-Managers are now often mistakenly referred to as Receivers notwithstanding their additional ability and authority to manage the debtor's business.

Both privately appointed or Court appointed Receivers or Receiver-Managers are required to make certain reports to the debtor and all of the debtor's creditors in accordance with the *BIA*. The Receivers or Receiver-Managers usually appointed over corporations are the Trustee in Bankruptcy divisions of various accounting firms.

Court Appointment

For ease of reference, and in accordance with the usual practice in Alberta, any reference to a Receiver that follows applies equally to the appointment of a Receiver-Manager.

The process of obtaining a Court Order appointing a Receiver involves the filing of a Statement of Claim in conjunction with the preparation of an Affidavit containing the particulars of the indebtedness, the security and the default of the debtor, together with an explanation of the necessity for the Court appointing a Receiver. The process of appointing the Receiver and securing the collateral can be accomplished reasonably quickly and, depending upon the degree of urgency involved, proceeds with only limited, if any, notice to the debtor.

An Order appointing a Receiver contains broad powers to take possession of and sell the collateral. As previously noted, a Receiver-Manager is also entitled to carry on the business of the debtor.

To the extent that the collateral is located within Alberta, the Receiver would be empowered to enter any premises and to enlist the aid of a civil enforcement agency or police to gain access to the collateral. Once an Order appointing a Receiver has been obtained in Alberta, it can quickly be registered in other provinces where collateral or business undertakings of the debtor might be located, by way of further Court applications in those other provinces to confirm the original Alberta Order.

Although the Court appointment of a Receiver is initially more cumbersome than the private appointment of a Receiver, a Court appointment often is preferred in that it provides additional access to the Courts in the future for advice, directions or assistance to the Receiver should future circumstances warrant. Also, an additional degree of safety is provided in that the future actions of the Receiver (such as considering a potential sale of the assets) can be vetted and validated by the Courts through the Receiver bringing an application for advice and directions with respect to the proposed course of conduct. Various government departments and registries such as the Land Titles Office and the Mines and Minerals office are much more at ease in dealing with a Court appointed, rather than a privately appointed, Receiver.

For these reasons, most significant Receiverships in Alberta (with assets over \$1 million) proceed by way of Court appointment.

Private Appointment

Most bank lending documents and other security agreements also include the right for the creditor to privately appoint a Receiver. A privately appointed Receiver is limited to the authority provided to it by virtue of the security documents.

A private appointment of a Receiver is accomplished without Court application by way of a letter to the Receiver effecting the appointment. This letter appointment is simply registered at Corporate Registry.

After a private appointment, the debtor company is put on notice of the appointment and a demand is made for access to and delivery up of the collateral. The privately appointed Receiver is not authorized, however, to forcibly enter the debtor's premises unless such Court authority is granted.

As with the Court appointed Receiver, a privately appointed Receiver would then take steps to deal with the debtor's assets providing notice to the debtor and other interested parties in accordance with the provisions of the *BIA*.

The advantage to a private appointment is that it is less expensive and often quicker to arrange in comparison to a Court appointment. Unless the debtor's continued cooperation is ensured, however, the original cost and time savings may be subsequently lost in attempts to deal with the debtor's assets.

(v) [Bankruptcy Trustee](#)

An unsecured creditor, or a secured creditor who anticipates a deficiency in the value of its security, can apply to the Courts for the appointment of a Trustee in Bankruptcy. The process for appointing a Trustee in Bankruptcy is more cumbersome than arranging for the Court appointment of a Receiver. As such, it is very rare that a secured lender would resort to the appointment of a Trustee in Bankruptcy rather than appointing a Receiver.

The *BIA* provides for a stay of proceedings to allow an organized realization of assets, calculation and organization of claims and distribution of assets in accordance with the scheme of distribution established by that Act. Bankruptcy proceedings are governed in Alberta by the Court of Queen's Bench.

One or more creditors may file a Petition for a Receiving Order by filing a Petition (similar to a Statement of Claim) supported by an Affidavit alleging that the petitioning creditor is owed at least \$1,000.00 that is unsecured and that the debtor has committed an act of bankruptcy within the preceding six months.

Section 42 of the *BIA* sets out the various acts of bankruptcy, the most common of which include:

"(f) if he exhibits to any meeting of his creditors any statement of his assets and liabilities that shows that he is insolvent, or presents or causes to be presented to any such meeting a written admission of his inability to pay his debts";

"(h) if he gives notice to any of his creditors that he has suspended or that he is about to suspend payment of his debts"; and

"(j) if he ceases to meet his liabilities generally as they become due".

Debtors should be careful not to inadvertently commit an act of bankruptcy as set out in Sections 42(f) or (h) when negotiating with their creditors.

If the creditors can establish a strong *prima facie* case of bankruptcy and the necessity for the immediate protection of the bankrupt estate, the Court has the discretion to appoint an Interim Receiver pending the hearing of the Petition for the Receiving Order.

There is an approximate 3 - 4 week delay between the filing of the Petition and the bankruptcy hearing.

If the debtor intends to dispute the Petition, it must file and serve its Notice of Dispute (similar to a Statement of Defence) setting out its grounds of dispute. In major disputed cases, further Affidavits supporting and disputing the Petition and examinations on these Affidavits may be filed. A Justice of the Court of Queen's Bench then hears the disputed application to determine if the petitioning creditor satisfied its burden of proof in establishing the bankruptcy of the debtor.

Administration of the Bankrupt Estate

The administration of the bankrupt estate proceeds in the same manner whether the bankruptcy arises as a result of an assignment by the debtor or a Petition by its creditors.

The trustee in bankruptcy (a licensed accounting firm who is not the auditor of the bankrupt) takes steps to identify and protect all of the assets of the bankrupt and notify all of the bankrupt's creditors. The trustee has the authority to continue to operate the bankrupt corporation but usually will immediately take steps to terminate all employees and most contracts with third parties. Various key employees to safeguard all assets and maintain essential contracts or services may be retained or re-hired as consultants.

A bankruptcy does not automatically terminate contracts between the bankrupt and third parties and the trustee will often take steps to protect and perhaps assign certain contracts on

favourable terms (such as purchase contracts for commodities at a price below market values). To maintain any contract, the trustee must, in a reasonable time, approbate the contract and call for its completion.

Conversely, if a contract is onerous or does not provide clear benefits to the trustee, the trustee will not perform the contract resulting in the aggrieved party being entitled to file a Proof of Claim as an unsecured creditor.

Within 21 days from the trustee's appointment, the trustee must hold the first meeting of creditors. Prior to this meeting, all known creditors are provided with a Proof of Claim form to be completed by the creditors, giving particulars of their claim including any security or priority that might be claimed.

At the first meeting of creditors, the trustee is approved or replaced and the creditors can vote on various issues concerning the estate including the appointment of up to five inspectors. Inspectors are the elected representatives of the creditors and act like a Board of Directors to give advice and directions to the trustee. Creditors are entitled to vote based upon the dollar value of their claim.

The trustee will then identify any assets for recovery, review and quantify creditors' claims and distribute any proceeds to the creditors. In reviewing creditor claims, the trustee can distribute the entitlement, security or amount claimed by a creditor. Any disputes between creditors and a trustee can be resolved through the Court through bankruptcy proceedings and applications that are generally much more expeditious than typical civil proceedings.

Section 136 of the *BIA* provides that secured creditors are paid first and then priority is given to particular claimants, including trustee and legal fees, wages (up to \$2000.00 per claimant), municipal taxes, rental arrears and accelerated rent (up to 3 months each), as well as tax indebtedness, with any remainder being split pro rata amongst the unsecured creditors.

In certain circumstances, the trustee can file a proposal to creditors in accordance with the *BIA* proposal provisions discussed below. If a proposal is not accepted or if the creditors are not paid in full, a corporate debtor will not be discharged from bankruptcy. The trustee will administer the bankrupt estate until all assets have been realized and will then be discharged as trustee, leaving the corporate debtor as an undischarged bankrupt.

The *BIA* contains a priority scheme for distribution of a bankrupt's assets that is slightly different than that set out by the governing Alberta legislation. If the debtor was not also declared a bankrupt, then the Alberta legislation would govern the distribution of property. Because the *BIA* is federal legislation, it would prevail where it is different from Alberta's priority rules. As such, in instances where certain claims would have priority over a secured lender in Alberta (usually unpaid

landlords and employees for limited amounts), the secured lender may wish to appoint both a Receiver and a Trustee in Bankruptcy. This dual appointment results in the inversion of priorities because secured creditors have priority over landlords and employees under the *BIA*.

(c) Set-Off

Canadian courts recognize both legal and equitable set-off.

Legal set-off arises where there are existing claims and cross-claims between identical parties. A bankruptcy or receivership destroys the required mutuality of debt for legal set-off as the debtor's assets are transferred to a third party (the receiver or trustee) while its obligations remain with the debtor.

In insolvency circumstances, a third party could still advance rights of set-off if the necessary requirements of equitable set-off were established. The Supreme Court of Canada established the following principals in its decision in *Telford v. Holt*:

1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands;
2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed;
3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross-claim;
4. The plaintiff's claim and the cross-claim need not arise out of the same contract; and
5. Unliquidated claims are on the same footing as liquidated claims.

Although the practice had developed to expressly limit or preclude rights of set-off in *Companies' Creditors Arrangement Act* ("CCAA") Orders, the CCAA has been amended to include the following:

"18.1 The law of set-off applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be."

Similar provisions are contained in section 97(3) of the *BIA*.

In the *Blue Range CCAA* proceedings, the Alberta Court of Appeal considered claims for set-off advanced by various long term purchasers of gas who had received 2 months of gas that they had not paid for but who also incurred much greater damages arising from Blue Range's repudiation of the long term supply agreements. The Court of Appeal found that the damages arising from the breach were sufficiently related to the purchaser's obligations to pay for gas delivered so as to allow rights of set-off to arise.

II. ARRANGEMENTS OR RESTRUCTURING OF DEBT UNDER BIA

The *BIA* provides for the appointment of a Trustee in Bankruptcy by way of Court Order arising from an assignment in bankruptcy of the debtor or as a result of a Petition filed by an unsecured creditor. The general policy under the *BIA* is that the bankruptcy of the debtor does not interfere with the rights of a secured creditor. As such, when a debtor assigns itself or is petitioned into bankruptcy, the rights of its secured creditors to realize upon their security pursuant to the terms of their security documentation remain largely unaffected.

Typically, upon a Trustee in Bankruptcy being appointed, the Trustee merely satisfies itself as to the validity of the security and then releases the secured assets to the secured creditors or their agent (ie. Receiver) for disposition. Where there is a surplus in the value recovered from the assets, the secured creditor is required to account to the Trustee for such a surplus. Where a shortfall exists, the secured creditor is entitled to file a Proof of Claim with the Trustee for the deficiency.

It is significant to note that the Trustee in Bankruptcy is treated in Alberta as the equivalent of a *bona fide* purchaser for value of the debtor corporation. As such, the Trustee is entitled to retain any collateral where the secured creditor has either failed to or has improperly registered its security interest.

Significant amendments were made to the *BIA* in 1992. These amendments included provisions for a potential restructuring of debt that is an alternative to the provisions of the CCAA.

Prior to these amendments, secured creditors were not affected when a proposal was filed under the *BIA*. The stay of proceeding provisions under the amended *BIA* now apply to both secured creditors as well as unsecured creditors.

Although there has been some suggestion that these amendments to the *BIA* will lead to the repeal of the CCAA, no such steps have yet been taken by the Federal government.

Because the *BIA* is more restrictive in the Court's discretion for the implementation of a Plan of Arrangement, most major Plans of Arrangement continue to proceed under the provisions of the

CCAA.(a) [Stay of Proceedings](#)

One of the primary advantages of proceeding under the *BIA* is that the initial stay of proceedings is obtained by simply filing a Notice of Intention to file a Proposal with the Official Receiver rather than having to proceed to obtain a Court Order. This stay of proceedings is effective as against all secured and unsecured creditors and any claim being advanced by the Crown. In conjunction with the filing of the Notice of Intention, the debtor must appoint a qualified Trustee to monitor its affairs.

The stay of proceedings is not effective, however, as against a secured creditor who has taken possession of the secured assets for the purpose of realization or who has given a Notice of Intention to Enforce Security under Section 244 of the *BIA* more than 10 days prior to the debtor's filing of the Notice of Intention.

The filing of a Notice of Intention to file a Proposal results in an automatic stay of proceedings. This stay can be (and usually is) extended by application to the Court of Queen's Bench for a further period, not to exceed 45 days at a time, to a maximum total stay of proceedings of 6 months. To grant an extension, the Court must be satisfied that the debtor is acting in good faith, with due diligence, is likely to make a viable proposal and that no creditor will be materially prejudiced by such an extension.

This statutory limit of a 6 month stay of proceedings is one of the main factors resulting in most complex arrangements proceeding under the provisions of the CCAA.

(b) [Classification of Creditors](#)

Section 50(1.4) of the *BIA* sets out some specific tests for determining the classification of secured claims. Secured creditors should be included in the same class if the interest of the creditors holding those classes of claims are sufficiently similar to give them a commonality of interest taking into account the nature of the debts giving rise to the claims, the nature of priority of the security with respect to those claims, the remedies available to the creditors and the proposed treatment of the claims under the proposal.

Where a dispute arises with respect to the classification of secured claims, application can be made for a determination by the Court.

(c) [Approval/Rejection of Proposal](#)

The *BIA* provides a procedure for the notice and conduct of the creditors meeting.

A report from a Trustee must be provided to creditors including a summary of the terms of the proposal, the financial position of the debtor and the identification and evaluation of the assets of the debtor corporation. In addition, the Trustee must recommend whether the proposal should be accepted by the creditors and the reasons for this recommendation.

To be successful, a proposal must be approved by each class of creditors by a majority in number representing at least 66 2/3% of the value of that class.

If the proposal is rejected by any secured class of creditors, the proposal fails and the stay of proceedings is lifted.

If, however, the proposal is rejected by the unsecured creditors, the debtor company is deemed to have made an assignment in bankruptcy and automatically becomes a bankrupt.

If each class of creditors approves the proposal, the proposal must be reviewed and approved by the Court. In considering a proposal, the Court will review its terms to ensure that it is fair and reasonable.

III. COMPANIES CREDITORS ARRANGEMENT ACT

The CCAA contains a provision that allows a company in financial difficulty to resist its creditors and to negotiate with them so as to attempt to avoid bankruptcy and carry on its business as a going concern. An application under the CCAA is usually initiated by the debtor company seeking protection.

To apply for protection under the CCAA, the debtor company must acknowledge that it is insolvent and it must have debts that exceed \$5,000,000.00.

The CCAA is a very short and generally worded statute and as such the ultimate procedure and outcome of proceedings are very much in the discretion of the Courts. In Alberta, the Courts will often provide applicant debtors a great deal of latitude so as to attempt to preserve the debtor company as an ongoing business concern. The CCAA now, however, requires that a Monitor be appointed for the debtor seeking protection.

Although the practices of the Court are dependent upon the specific case before it, there are a number of principles that should be noted:

(a) Stay of Proceedings

The Court is empowered under Section 11 of the CCAA to provide for, on an initial application, a stay of all proceedings for up to 30 days. Any further applications for a stay are at the Court's discretion with no set limits.

The Courts have interpreted their authority under the CCAA to allow the Courts to compel key suppliers to continue supplying the debtor company (usually on a C.O.D. basis) if such supplies are necessary to allow the company to continue while it attempts to formulate its proposal to its creditors. The topic of forcing a continued supply of commodities will be reviewed at length later in this paper.

Although the CCAA does not prescribe the time for the holding of the meeting of the creditors to vote on the Plan of Compromise, the Courts usually require that the first meeting be held within a few months after the initial filing requesting the Court protection. If additional time is required to negotiate the Plan of Compromise or Arrangement, the Court will typically extend the stay of proceedings after receiving ongoing reports from the interested parties. There have been recent CCAA proceedings in Canada, however, where, because of the complexity of the proposed restructuring or arrangement, periods in excess of one year have passed between the initial filing and the meeting of creditors to consider the proposed arrangement.

Any creditor subject to a stay under the CCAA can bring application before the Court for an Order setting aside the stay. The usual circumstance where the Court will lift a stay of proceedings under the CCAA is where the creditor can establish that the Plan of Arrangement is doomed to failure as a result of opposition by that creditor or a group of creditors.

(b) Creation of Classes

The most contentious practical issue and the issue most often litigated by creditors arises from the classification of creditors.

For an arrangement to be successful, a majority in number representing two-thirds of the value of that class must vote in favour of a plan for it to be approved by that class. As such, creditors who are vocal in their opposition to a Plan of Arrangement are often placed in a class of creditors who support the plan to ensure that the majority in number and two-thirds in value of creditor approval exists so as to bind that objecting creditor.

The CCAA does not contain any specific guidelines on how to determine the various classes of creditors and as such the final determination is subject to the Court's discretion. In apparent attempts to ensure that a proposed Plan of Arrangement is not defeated by a minority of creditors, Courts will often accept the creative creation of classes proposed by the debtor seeking to stack a class so as to ensure the requisite voter approval. Courts generally express the test to be applied to determine classes of creditors as being whether the creditors in any specific class have a "commonality of interest" but again this is subject to some manipulation by the debtor attempting to arrange approval.

(c) [Approval/Rejection of Proposed Arrangement](#)

A Plan of Arrangement must first be approved by the various classes of creditors by a majority in number and two-thirds in value of each class.

The CCAA does not provide for a cram down where one class of creditors rejects a proposal that is approved by the other classes of creditors. As such, a secured lender effectively maintains a right of veto with respect to a plan unless it can be placed into a class of creditors where it has less than 33 ⅓% of the value of the indebtedness.

As a general rule, where a single class of creditors votes against a plan, the entire Plan of Arrangement fails. In the 1993 *Olympia & York Developments Ltd.* Plan of Arrangement, however, the plan specifically provided that it would be effective only as against those classes of creditors who voted in favour of the plan while classes of creditors who voted against the plan were free to enforce their rights of recovery. Such an arrangement was effective in the *Olympia & York* case because the various lenders each dealt with *Olympia & York* on a project by project basis. As such, each class of creditors was usually made up of various lenders to a particular building project (which was also usually held in a single purpose subsidiary corporation).

Once a plan has been approved by the various classes of creditors, the plan must still be reviewed, approved and sanctioned by the Court (in Alberta, the Court of Queen's Bench). The Court will look both to ensure that there has been compliance with the statutory requirements of the CCAA and also to ensure that the plan is fair and reasonable.

As such, a proposed Plan of Arrangement which is unduly harsh upon a particular lender or group of lenders who may have been ineffective in their dissent by virtue of the creation of classes, might still not become enforceable if those creditors can show that the plan is unfair or unreasonable.

Once the Plan of Arrangement has been approved by the various classes of creditors and sanctioned by the Court, it is binding on all creditors, including the creditors who voted against the plan, and the debtor company.

If the plan is rejected by any of the classes of creditors or by the Court, the stay of proceedings is lifted and the company proceeds, subject to any action that might be undertaken by its creditors.

IV. [ELIGIBLE FINANCIAL CONTRACTS](#)

Traditionally, CCAA Orders require third parties to continue supplying or purchasing under agreements with the debtor company notwithstanding historic defaults or express provision in the sales/purchase agreement excusing performance in the event of the insolvency of

the debtor - so long as the debtor remains current or provides security for post-petition obligations. A debtor corporation enjoying the stay of proceedings against it under the CCAA will often then terminate agreements considered unfavourable (allowing its counterparty to file an unsecured claim for any damages arising from any repudiation) while requiring the performance of all contracts where the debtor enjoys advantageous terms.

Canadian parliament sought to incorporate provisions similar to the concept of “forward contracts” under the provisions of the U.S. Bankruptcy Code which exempted certain types of contracts from the effect of a stay in an insolvency restructuring.

As such, subsections 11.1(2) and (3) of the CCAA¹ were amended to provide as follows:

“(2) **No stay, etc. in certain cases** - No order may be made under this Act staying or restraining the exercise of any right to terminate, amend or claim any accelerated payment under an eligible financial contract...

(3) **Existing eligible financial contracts** - For greater certainty, where an eligible financial contract entered into before [an initial order, including a stay order] is made under section 11 is terminated on or after the date of the order, the setting off of obligations between the company and the other parties to the eligible financial contract, in accordance with its provisions, and if net termination values determined in accordance with the eligible financial contract are owed by the company to another party to the eligible financial contract, that other party shall be deemed to be a creditor of the company with a claim against the company in respect of the net termination values.”

This exception to the stay is limited to rights to terminate, amend, claim any accelerated payment or set off that exist in the terms of EFC; such rights to not arise automatically if the contract is an EFC².

A. **Statutory Definition of Eligible Financial Contracts**

The term “eligible financial contract” is defined in s. 11.1 of the CCAA³ to mean

- a. a currency or interest rate swap agreement,
- b. a basis swap agreement,

¹ Virtually identical provisions are contained in section 65.1 of the *BIA*

² Unlike forward contracts under the United States Bankruptcy Code, there is no requirement that the parties to the EFC be designated as “forward contract merchants”

³ Virtually identical provisions are contained in section 65.1(7) of the *BIA*

- c. a spot, future, forward or other foreign exchange agreement,
- d. a cap, collar or floor transaction,
- e. a commodity swap,
- f. a forward rate agreement,
- g. a repurchase or reverse repurchase agreement,
- h. a spot, future, forward or other commodity contract,
- i. an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities,
- j. any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i),
- k. any master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j),
- l. any master agreement in respect of a master agreement referred to in paragraph (k),
- m. a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (l), or
- n. any agreement of a kind prescribed.

B. Consideration of Canadian Courts

The Alberta Court of Appeal decision in the Blue Range⁴ CCAA proceedings was the first Appellate Canadian judicial review of EFCs under the CCAA or *BIA*.

That case dealt with various counterparties who held gas purchase agreements with Blue Range. In its decision, the Court of Appeal noted the developed derivative and risk management commodity markets, and noted that contracts involving physical delivery were a component of that developed market.

The Court noted that while the contracts contemplated “physical settlement by delivery of natural gas,” they nonetheless fit within existing notions of forward commodity contracts. The Court stated:

“The agreements also serve an important financial purpose which is unrelated to physical or financial settlement; they are risk management tools, commonly known as “hedges.””

The court emphasized the significance of risk management in the derivatives market:

⁴ [2000] A.J. No. 1032 (Alta. C.A.)

“If the right to terminate contemplated in the agreement ... is not enforceable, the whole structure of risk management for the swaps and other transactions is weakened or may fall apart.” at 231 [citation omitted]. The effect of non-enforceability on the derivatives market is worth exploring.”

In concluding that the subject master gas agreements were EFCs exempt from the CCAA stay, the Court also considered the practical effect of potentially differing from established U.S. practices as follows:

“If forward gas contracts are not exempt from the CCAA stay provisions and no offsetting deductions are permitted, available credit quickly will be gobbled up. As a result, risk management companies will limit the capital they can allocate to this market, or ask cash-strapped gas producers to put up additional security to cover any short-falls.”

In the Androscoggin⁵ CCAA proceedings, the Ontario Court of Appeal considered various gas supply agreements to Androscoggin’s Maine⁶ co-generation facility.

The Ontario Court of Appeal considered the Blue Range decision and the U.S. concept of forward contracts. It stated:

“It is abundantly clear that the purpose of the EFC amendments was to put Canada on an even playing field with the United States.”

After reviewing the contract in its entirety and the rationale for the various supply agreements, the Ontario Court of Appeal found that the Androscoggin supply agreements were not EFCs and concluded as follows:

“The contracts in issue before Fruman J.A. [Blue Range Appellant Justice] served a financial purpose unrelated to the physical settlement of the contracts. The reasons in *Blue Range Resources Corp.* indicate that the contracts Fruman J.A. examined enabled the parties to manage the risk of a commodity that fluctuated in price by allowing the counterparty to terminate the agreement in the event of an assignment in bankruptcy or a CCAA proceeding, to offset or net its obligations under the contracts to determine the value of the amount of the commodity yet to be delivered in the future, and to re-hedge its position. Unlike the contracts found to be EFCs in *Blue Range Resources Corp.*, *supra*, the contracts in issue here possess none of these hallmarks and cannot be characterized as EFCs. However, mere *pro forma* insertion of such terms into a contract will not result in its automatic characterization as an EFC. Regard must be had to the contract as a

⁵ [2005] O.J. No. 592 (CA)

⁶ Androscoggin had filed concurrent CCAA and United States Chapter 11 proceedings

whole to determine its character.” [emphasis added]

As such, while the insertion of the parties' declaration of the intention the agreement is an EFC is helpful⁷, it is not determinative of the issue.

The Blue Range and Androscoggin decisions were recently considered and applied by the Alberta Court of Queen's Bench in the Calpine Canada Energy Limited⁸ CCAA proceedings.

In that case, a counterparty to a gas call on production agreement (“COP Agreement”) took the aggressive step of terminating performance under the COP Agreement in the face of a CCAA stay (apparently on the advice and expectation that the COP Agreement was an EFC exempt from the stay).

The Alberta Court of Queen's Bench disagreed with that position and concluded that the CCAA stay precluded termination of the COP Agreement, notwithstanding a specific provision in the COP Agreement allowing for termination in the event of a CCAA filing.

The Court noted that it remained a difficult issue to define what is an EFC absent a more refined definition in the CCAA legislation. The Court again reviewed the terms of the contract as a whole and the absence of a risk management component (as opposed to price and delivery certainty) in concluding the COP Agreement was not an EFC.

V. ARRANGEMENTS UNDER THE PROVISIONS OF THE BUSINESS CORPORATIONS ACT

Corporations in Canada can be incorporated under the provisions of the *Canada Business Corporation Act* ("CBCA") or the provisions of the Corporation Acts of the various Provinces, including the *Alberta Business Corporation Act* (the "ABCA").

Each of these various Corporation Acts contain similar provisions with respect to a potential arrangement of a corporation's shares or its creditors.

Various corporations have recently completed arrangements under the provisions of the Business Corporations Acts rather than the *BIA* or CCAA as such an arrangement does not necessitate an admission of insolvency by the debtor. This may be an important factor where the corporation wishes to continue in business even if the arrangement is rejected by its creditors where an admission of insolvency may violate or allow acceleration pursuant to the terms of various loan agreements.

⁷ Such a provision is contained in 16.14 of the Draft Environmental Attribute Agreement

⁸ Decision of Romaine J. dated February 24, 2006, currently unreported

The provisions under the *ABCA* are typical of the governing provisions in the other various Business Corporation Acts and as such any potential restructuring under the *ABCA* would be similar to corporate restructuring that have occurred in most other provinces.

Part 15 of the *ABCA* (Sections 192 - 193) allows for Court ordered reorganizations and arrangements.

Section 193(1)(h) provides that arrangements include a compromise between the corporation and its creditors or any class of its creditors. As previously noted, there is no requirement under the provisions of the *ABCA* requiring the debtor corporation to be insolvent.

Upon an application being advanced by the debtor corporation by way of an Originating Notice of Motion, the Court, unless it dismisses the application, shall Order:

"193(4)

- (a) the holding of a meeting of shareholders;
- (b) a meeting of the persons who are creditors or holders of debt obligations of the corporation . . . if the court considers that those persons or that class of persons are affected by the proposed arrangement."

Although there is no specific provision in the *ABCA* for a stay of proceedings pending the meeting and possible approval of the Plan of Arrangement, the Alberta Court of Queen's Bench does have an inherent jurisdiction to grant a stay pursuant to Section 17(1) of the *Judicature Act*. In the recent arrangements conducted in Alberta under the provisions of the *ABCA*, no stay was actually obtained but the debtors made it clear to their creditors that such an application would be made if any creditor attempted to enforce its security and further made their creditors aware that they would be willing to resort to an application under the provisions of the CCAA if an acceptable stay was not granted in regards to the proposed *ABCA* arrangement.

Similar to the CCAA, the *ABCA* provides no guidance to the Courts as to how they determine the classes of creditors. As such, the Courts have used a similar "commonality of interest" test when setting the classes of creditors under the *ABCA*.

The *ABCA* requires approval of a proposal by a majority in number representing at least 2/3 of the amount of the claims in each particular class.

Section 193(9) of the *ABCA* provides the Court of Queen's Bench with broad discretionary powers to approve or refuse a proposed arrangement or make any other Orders that it sees fit.

If a Plan of Arrangement is approved by the various classes of creditors and the Court, it will become effective upon all of the creditors of the corporation. If the plan is rejected, the company will simply proceed to carry on business.

Although there is no significant difference in the procedures for an arrangement under the *ABCA* as compared to the provisions of the *CCAA*, uncertainty with respect to the ability and potential scope of the stay of proceedings has resulted in most corporations making arrangements under the *CCAA* rather than the provisions of the *ABCA*.

VI. REVIEWABLE TRANSACTIONS

Canadian legislation provides remedies for bankruptcy trustee's or creditors that are damaged by a bankrupt or debtor that makes improper payments or transfers of property to certain creditors or third parties to the detriment of the remainder of the creditor pool. While portions of this legislation reads similar to provisions contained in the U.S. Bankruptcy Code, in practice the preference legislation is less intrusive in Canada as creditors are provided an opportunity to advance due diligence and *bona fides* defences in response to a fraudulent preference or conveyance claim.

Legislation

Federal preference legislation is contained within the *BIA*. Its application is limited to instances where the debtor has been formally assigned or Petitioned into bankruptcy.

Each province also maintains preference legislation that applies to both bankrupt and non-bankrupt entities.

In Alberta, the reviewable transaction legislation is contained in the *Fraudulent Preferences Act* (R.S.A. 1980, c. F-18 ("*FPA*")) and hold over legislation from England being the *Statute of Elizabeth* (13 Eliz. c. 5, 1571).

Although similar, fraudulent conveyances and fraudulent preferences should be distinguished from each other. Preferences are premised on the existence of a debtor - creditor relationship whereby one creditor receives favourable treatment to the detriment of the other creditors. A fraudulent conveyance occurs when a transfer of property is made to a non-creditor to the detriment of existing creditors.

Fraudulent Conveyances

Section 1 of the *FPA* provides:

1 Subject to sections 6 to 9, every gift, conveyance, assignment, transfer, delivery over or payment of goods, chattels or effects or of bills, bonds, notes or securities or of

shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal made

- (a) by a person at a time when he is in insolvent circumstances or is unable to pay his debts in full or knows that he is on the eve of insolvency, and
- (b) with intent to defeat, hinder, delay or prejudice his creditors or any one or more of them,

is void as against any creditor or creditors injured, delayed, prejudiced.

The Statute of Elizabeth reads, in part::

. . . which feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments and executions, have been and are devised and contrived of malice, fraud, covin, collusion or guile, to the end, purpose and intent, to delay, hinder, or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries and reliefs . . .

Be it therefore declared, ordained and enacted by the authority of this present parliament. That all and every feoffment, gift, grant, alienation, bargain and conveyance of lands, tenements, hereditaments, goods and chattels, or of any of them, or of any lease, rent, common or other profit or charge out of the same lands, tenements, hereditaments, goods and chattels, or any of them, by writing or otherwise, and all and every bond, suit, judgment and execution . . . to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken . . . to be clearly and utterly void, frustrate and of none effect . . .

The settlement provisions of Section 91 of the *BIA* reads as follows:

91 (1) Any settlement of property made within the period beginning on the day that is one year before the date of the initial bankruptcy event in respect of the settlor and ending on the date that the settlor became bankrupt, both dates included, is void against the trustee.

(2) Any settlement of property made within the period beginning on the day that is five years before the date of the initial bankruptcy event in respect of the settlor and ending on the date that the settlor became bankrupt, both dates included, is void against the trustee if the trustee can prove that the settlor was, at the time of making the settlement, unable to pay all the settlor's

debts without the aid of the property comprised in the settlement or that the interest of the settlor in the property did not pass on the execution thereof.

- (3) This section does not extend to any settlement made
- (a) before and in consideration of marriage;
 - (b) in favour of a purchaser or encumbrancer in good faith and for valuable consideration; or
 - (c) on or for the spouse or children of the settlor of property that has accrued to the settlor after marriage in right of the settlor's spouse or children.

The fraudulent conveyance provisions in each of the *FPA* and the *BIA* essentially require the Trustee or complaining creditor to establish an intention to prejudice other creditors or, conversely, an absence of good faith and no *bona fides* consideration. In reviewing such cases, courts generally refer to the existence of “badges of fraud” in determining whether an attack on an impudent transaction can prevail. Such badges of fraud typically consider the relationship between the parties, the severity of existing or impending financial difficulties, the reasonableness of purported consideration, any secrecy with respect to the transaction, etc.

When a fraudulent conveyance application is successful, judgment is awarded as against the debtor and the recipient of the transfer compelling the return of the property and/or monetary judgment in an amount equal to the value of the property so that the trustee and remaining creditors are put in the same position as if the impugned conveyance had not occurred.

The granting of security to prior unsecured debt may constitute a reviewable fraudulent conveyance. The granting of security for new, fresh advances even by an insolvent company or a company on the eve of insolvency, is generally found to be a *bona fide* transaction where the security received is relatively equivalent to the fresh advances being made.

Fraudulent Preferences

A fraudulent preference may arise where a debtor has transferred assets to a creditor such that that creditor receives a greater share of the debtor's assets than they are otherwise entitled. Of course, the issue of creditor preferences recognizes that *bona fide* secured creditors are entitled to payment or property in priority to subordinate or unsecured creditors.

Sections 2 and 3 of the *FPA* provide:

2 subject to sections 6 to 9, every gift, conveyance, assignment, transfer, delivery over or payment of goods, chattels or effects or of bills, bonds, notes or securities or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal made

(a) by a person at a time when he is in insolvent circumstances or is unable to pay his debts in full or knows that he is on the eve of insolvency, and

(b) to or for a creditor with intent to give that creditor preference over the other creditors of the debtor or over any one or more of them,

is void as against the creditor or creditors injured, delayed, prejudiced or postponed.

3 subject to sections 6 to 9, every gift, conveyance, assignment, transfer, delivery over or payment of goods, chattels or effects or of bills, bonds, notes or securities or of shares, dividends, premiums or bonus in any bank, company or corporation, or of any other property, real or personal, made

(a) by a person at a time when he is in insolvent circumstances or is unable to pay his debts in full or knows that he is on the eve of insolvency, and

(b) to or for a creditor and having the effect of giving that creditor a preference over the other creditors of the debtor or over any one or more of them,

is, in and with respect to any action that within one year thereafter is brought to impeach or set aside the transaction, void as against the creditor or creditors injured, delayed, prejudiced or postponed.

Sections 95 and 96 of the *BIA* read as follows:

95(1) Every conveyance or transfer of property or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any insolvent person in favour of any creditor or of any person in trust for any creditor with a view to giving that creditor a preference over the other creditor is, where it is made, incurred, taken or suffered within the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the insolvent person became bankrupt, both dates included, deemed fraudulent and void as against the trustee in bankruptcy.

(2) Where any conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in subsection (1) has the effect of giving any creditor a preference over other creditors, or over any one or more of them, it shall be presumed, in the absence of evidence to the contrary, to have been made, incurred, taken, paid or suffered with a view to giving the creditor a preference over other creditors, whether or not it was made voluntarily or under pressure and evidence of pressure shall not be admissible to support the transaction.

96. Where the conveyance, transfer, charge, payment, obligation or judicial proceeding mentioned in section 95 is in favour of a person related to the insolvent person, the period referred to in subsection 95(1) shall be one year instead of three months.

The *FPA* preference provisions apply only to transfers of assets, and not payments of money to a creditor.

While the *BIA* preference provisions can also apply to a payment of money, they are generally not applied as widespread as the similar U.S. Bankruptcy Code provisions in that fraudulent preferences (including the payment of money) have been found to be *bona fide* in circumstances where:

- (a) the transaction was entered into in the ordinary course of business;
- (b) the transaction was made in fulfillment of the debtor's obligations under a pre-existing agreement;
- (c) the transaction was made with a dominant intent (viewed objectively) of attempting to remain in business or to secure more favourable credit terms.

Conclusion

An aggrieved creditor or a trustee in bankruptcy has numerous legislative tools to challenge fraudulent transactions where a creditor or third party improperly receives distributions from an insolvent debtor or bankrupt. That being said, numerous defences to validate the transaction have been accepted by the Canadian Courts. As a result, there typically is a requirement of an improper intent or improper relationship to support a reviewable transaction claim. Arms length *bona fide* purchasers or vigilant creditors are protected from claims even where a mathematical benefit is obtained.

VII. DISTINCTION BETWEEN U.S. AND CANADIAN RE-ORGANIZATION LEGISLATION

Canadian

U.S.

Recognition of Foreign Bankruptcy

Part XIII of *BIA* provides for recognition of foreign representatives and bankruptcy proceedings in Canada.

Sections 304 to 306 of the Bankruptcy Code (the "Code") list factors for recognition of foreign bankruptcy orders.

Effect of Filing for Reorganization

Debtor merely continues in business with protection from court pending plan of arrangement

Assets of the debtor are a distinct estate being managed by debtor pending plan of arrangement

Appointment of Monitor/Trustee

CCAA - monitor appointed to report to court

Trustees rarely appointed unless fraud, dishonesty, incompetence or gross mismanagement by current management

BIA – interim trustee appointed to report to court

Eligibility for Reorganization

BIA and CCAA - debtor must be insolvent

CCAA - must have in excess of \$5,000,000 of debt

ABCA - no requirement for insolvency nor financial difficulty

No requirement for insolvency but must be experiencing financial difficulty

U.S. Courts more likely to presume in favour of the debtor reorganization

Screening for Eligibility

Canadian Courts more inclined to reject court protection at an early stage

Effect of Stay on Secured Creditors

Secured creditor in possession of collateral or who had provided sufficient notice not obliged to return collateral nor affected by stay under *BIA*

Secured creditor who seized assets may be obliged to return assets

Effect of Significant Creditor Opposition

Canadian Courts very willing to refuse or withdraw court protection where arrangement doomed to failure

American Courts reluctant to interrupt creditor protection

Creditors Committees

No statutory authority for creditors committees but practice beginning to develop in significant CCAA cases

Chapter 11 (Code) provides for creditors committees in every case

Cram Downs

No cram down allowed as against a dissenting class of creditors

Chapter 11 (Code) allows for courts to cram down a dissenting class of creditors

Paying dissenting Creditors in Full

No statutory allowance for paying creditors in full but similar result can be achieved by not including that class of creditors in Plan of Arrangement

Chapter 11 (Code) provides for paying a dissenting class of creditors in full

Duration of Reorganization

BIA - 30 days with five 45 day extensions (6 months)

No specific period. Courts more likely to allow indefinite protection

CCAA – Original 30 day stay with specific period but usually quicker than U.S. plans

Effect of Rejection of Arrangement

BIA – automatic bankruptcy if rejected by unsecured creditors

Courts more likely to continue protection to allow modification of proposal

CCAA – admission of insolvency usually leads to receivership if plan rejected

Eligible Financial Contracts

CCAA section 11.1 and *BIA* section 65.1(7) preclude any stay Order from affecting rights of set-off, acceleration or termination included in certain financial contracts

Sections 362, 556 and 560 of the Code provides similar rights