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The COVID-19 Pandemic and the Insolvency Laws in Canada: A Primer

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The COVID-19 pandemic is, first and foremost, a human and health crisis. Social and physical distancing has been the almost universal response to this pandemic. The effect of social distancing on the economy, however, is significant.

In this three part series of articles, we will examine the fundamentals of insolvency laws as they presently stand in Canada, we will then review and examine how the relationships between creditors and debtors have changed during this time of the pandemic and finally we will look at some new and different approaches to work out debt issues that have been undertaken during this time of the virus including the mitigating factors of governmental assistance.

The Conference Board of Canada has issued a report outlining the economic implications of social distancing. The key findings of that report indicate that assuming the social distancing measures and travel bans continue until the end of August in both Canada and United States:[1]

1. GDP is forecast to contract by 1% in 2020.
2. The economy will shed over 330,000 jobs and unemployment will rise to 7.7%.
3. Industry servicing tourism, non-essential retail stores, household services and resource sector construction will be hit the hardest and may separate double-digit declines.
4. As a result of a recession in the USA, exports of goods and services are forecast to decline in real terms by 2.2% in 2020.
5. Oil prices will remain low and investment in the oil patch will continue to contract.
6. Real estate markets will cool significantly.

A likely consequence of this economic impact is that many businesses and individuals will be unable to meet their obligations generally as they become due or their liabilities will exceed the

value of their assets. This state of financial affairs constitutes insolvency.[2] When a business or an individual is insolvent, certain laws are available that provide financial protection.

These laws are found in two Statutes in Canada: the *Company's Creditors' Arrangement Act* (the "***CCAA***")[3] and the *Bankruptcy and Insolvency Act* (the "***BIA***").[4]

The *BIA* has two separate voluntary proceedings which provide relief to debtors; the assignment and the proposal. Proposals are available to consumers ("**Consumer Proposal**")[5] and to businesses ("**Division I Proposal**").[6]

Making a Proposal

In a proposal, (**Consumer** or **Division I**) the insolvent debtor obtains 30 day protections from their creditors by filing a Notice of Intention.[7] This allows the debtor time to organize his affairs and make an offer to his creditors to pay them a certain amount of the debt that is owed (a "**Proposal**"). A Proposal is supervised by a licensed trustee who is called a proposal trustee.[8]

If the Proposal is accepted by the requisite number of creditors (more than 50% of the creditors in number, holding more than 66 2/3% of the value of the claims under the Proposal) voting at a meeting,[9] and if the Court thereafter approves the proposal,[10] the debtor emerges from the proposal process and can then carry on business in the ordinary course.

If the Proposal is not accepted by the requisite amount of creditors, the debtor is deemed to have been bankrupt as of the date of the making of the proposal.[11] The proposal trustee then becomes a trustee in bankruptcy.

Making an Assignment

Instead of making a proposal to its creditors, a debtor can also make an assignment into bankruptcy, whereby the debtor voluntarily agrees to have all the property owned by the debtor vest in a licensed trustee (Bankruptcy Trustee), and thereafter to have those assets distributed by the trustee to his creditors in accordance with law.[12]

Creditors are also permitted to start proceedings so as to place debtors into bankruptcy. This is commenced by the creditor initiating a bankruptcy application. The creditor must be able to prove, however, that the debtor has committed an act of bankruptcy.[13] Most often it would involve proving that the debtor is insolvent. If they are able to do that, the debtor is then bankrupt and his property vests in the trustee in bankruptcy.[14]

The trustee in bankruptcy is then under an obligation to collect the debtor's property, realize upon it and distribute the proceeds of realization in accordance with law.[15] Individual debtors must then obtain a discharge from the court. Debtors that are corporations cannot be discharged from bankruptcy. Most first-time bankrupts will be eligible for an automatic discharge nine months after filing for bankruptcy, and most second-time bankrupt will be eligible for an automatic discharge 24 months after filing. As of the third bankruptcy, an individual debtor is no longer eligible for an automatic discharge, and is required to go to court to be discharged.[16]

CCAA Proceedings

For larger corporations which have debts in excess of $5 million and are insolvent, they are entitled to seek relief under the *CCAA*.[17]

If an order is granted under the *CCAA*, the debtor is provided 30 days protection from its' creditors so as to allow it, to restructure its' affairs and make a proposal to its creditors.[18] This 30 day protection is often extended significantly especially when dealing with larger corporations. The court officer who supervises the proceedings is known as the monitor.[19] The proposal must be accepted by more than 50% of the creditors holding 66 2/3% of the value of the claims in the estate who vote at a meeting.[20]

Although the original intent of the CCAA was to restructure corporations and businesses, it has become increasingly used as a method by which a corporation itself liquidates, such as the Target Corporation and Sears Canada.

Appointment of a Receiver

Another form of liquidation which is available to certain creditors who have obtained security in the property of its debtors (secured creditors) is the appointment of a receiver. This appointment can either be done privately or by way of court order.[21] In this process, the court-appointed receiver and the privately appointed receiver generally act on behalf of and in the best interest of the secured creditor. The appointment is generally triggered when the debtor defaults on their obligations owed to the secured creditors. Generally, receivers are mandated to collect property owned by the debtor and liquidate it, and thereafter, distribute the proceeds to the secured creditor.[22] The balance, if any, is distributed to the other creditors in accordance with law.

Stay Tuned...

The relationship between creditors and debtors are evolving on a day by day basis. Deferral of payments by leasing companies, banks and other financial institutions are occurring daily. Forbearance on loans is the new modus operandi for financial institution and mortgage enforcement is on a hiatus.

Federal and provincial assistance for businesses and employees are announced regularly.

We will keep track of all these changes and provide them to you in our next two installments.

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[1] Conference Board of Canada, "Economic Implications of Social Distancing – Alternate Canadian Outlook Scenario" (March 2020) at 3, online (pdf): < https://www.conferenceboard.ca/temp/e1707961-efab-4ecf-a2ec-288b096b32f7/10659_Economic%20Implications%20of%20Social%20Distancing_IB.pdf>.

[2] *Bankruptcy and Insolvency Act*, RSC, 1985, c B-3 [*BIA*], s 2 – definition of "insolvent person".

[3] *Companies' Creditors Arrangement Act*, RSC, 1985, c C-36. [*CCAA*].

Note that in this paper we will not be discussing Plans of Arrangements provided for in the Ontario *Business Corporations Act*, RSO 1990, c B16 and the *Canada Business Corporations Act*, RSC, 1985, c C-44.

[4] *BIA*.

[5] *BIA*, ss. 66.11-66.4

[6] *BIA*, ss. 50-66.

[7] *BIA*, s 50.4.

[8] *BIA*, s 50(10).

[9] *BIA*, s 54(2).

[10] *BIA*, s 58.

[11] *BIA*, s 57.

[12] *BIA*, ss 49(1), 49(4).

[13] *BIA*, 43(1).

[14] *BIA*, 43(9).

[15] *BIA*, ss 17, 30,

[16] *BIA*, s 168.1; Bankruptcy Canada, “Your Bankruptcy Discharge” (2020), online: <https://bankruptcy-canada.com/how-to-file-bankruptcy-canada/bankruptcy-discharge/>

[17] *CCAA*, s 3.

[18] *CCAA*, s 32.

[19] *CCAA*, ss 2, 11.7.

[20] *CCAA*, s 6.

[21] *BIA*, s 243.

[22] *BIA*, s 243(2).

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