A REVIEW OF THE
COMPANIES' CREDITORS ARRANGEMENT ACT

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The *Companies' Creditors Arrangement Act* (or CCAA) was legislated by the Government of Canada during the 1930's. The Act did not come into the mainstream until the 1980's when many corporations were faced with restructurings of varying descriptions. This Article is intended to provide an overview of the Act itself and to assist clients in obtaining an understanding of the structure of the CCAA. Please contact the authors, or members of our Realizations & Insolvency Team or our Securities Team for more specific information.

I. INTRODUCTION

During the Great Depression, the Government of Canada recognized the need for legislation which could be used to facilitate the financial restructuring of insolvent corporations. The *Companies' Creditors Arrangement Act* (commonly referred to as the "CCAA") was passed by Parliament in 1933 but was not widely used to carry out restructurings of corporations until the 1980's. It became the statute most often used for larger corporate restructurings by insolvency law practitioners and consultants since 1980 largely because of its flexibility - it is simple legislation without a lot of rules and at the same time, it gives the Court a great deal of discretion in granting orders to solve practical problems encountered in complex cases. Since 1980, there has been an explosion of reported cases from Courts across Canada dealing with CCAA issues and over the same period, an impressive track record of successful restructurings of insolvent corporations has developed. The Court in Alberta has been a leader in the field of development of important precedents in the interpretation and use of the CCAA.

The CCAA was amended by the coming into force of Bill C-5 on September 30, 1997. The purpose of this paper is to provide an up-to-date overview of the provisions of the CCAA including the 1997 amendments. We will discuss the procedure under the CCAA to bring a plan before the creditors for consideration and, if approved by them, to the Court for final sanction. We will outline the matters to be taken into account by the Court in determining whether a plan should be approved by it. We will also briefly discuss certain collateral issues such as the effect a successful plan has under the CCAA in respect of liability of guarantors or co-debtors of the debtor company and whether a CCAA plan can also deal with directors' liabilities, the role of the monitor, use of creditors' committees and environmental liability issues. It is our intention that this overview will assist our clients to identify situations where the CCAA may be of some benefit, and to have a working knowledge of the basic structure of the CCAA. This is not intended to be a technical paper for lawyers, but rather an informal review for the benefit of those who may not be familiar with the CCAA and its advantages for restructuring.

General Purpose and Scheme of the Act

The long title of the CCAA is: "An Act to facilitate compromises and arrangements between companies and their creditors". Recent case law has aided in the creation of a comprehensive, but not exhaustive, list of the purposes of the CCAA:

a. to permit an insolvent company to avoid or be discharged from bankruptcy by making a compromise or arrangement with its creditors;

b. to permit a company to remain in business notwithstanding that it is insolvent;

c. to protect an insolvent company from proceedings by creditors which would prevent the company from carrying out the terms of a compromise or arrangement;

d. to protect the interests of creditors and to permit an orderly distribution of the debtor company's affairs;

e. to maintain the *status quo* for a period while the insolvent company attempts to gain the approval of its creditors for an arrangement which will enable the company to remain in operation for the future benefit of the company and its creditors;

f. to permit equal treatment of creditors of the same class; and

g. to preserve the insolvent company as a viable operation and to reorganize its affairs to the benefit not only of the debtor but of the creditors.

The CCAA is the closest statutory framework Canadians have to Chapter 11 "Debtor in Possession" proceedings under the U.S. Bankruptcy Code. Under the CCAA, the debtor company remains in possession of its assets and can apply to the Court for an order staying all proceedings against it pending a meeting of its creditors to vote on a proposed Plan of Arrangement. The initial application to the Court under CCAA is usually done on an ex-parte basis, ie. without notice to the creditors. Under the 1997 amendments, the initial application to the Court must be accompanied by the filing with the Court of the debtor company's projected cash flow and financial statements. The stay granted by the Court will be limited to 30 days on the initial application with a provision for additional applications to be made to extend the stay. The Canadian experience under CCAA seems to indicate that a restructuring under CCAA usually takes 6 to 12 months to accomplish. The debtor company only needs to establish due diligence and good faith in respect of its efforts to carry out a successful restructuring with its creditors in order to obtain a continuance of the stay. However, a creditor or group of creditors can come before the Court at any time while the stay of proceedings is in effect to request that the stay be terminated, either with respect to specific collateral or generally, if the creditors can prove prejudice.

Justice Gregory Forsyth's decision in an Alberta case known as *Norcen Energy* v. *Oakwood Petroleum* is considered to be a landmark judgment in the analysis of the Court's power to grant a stay of all proceedings against a debtor company under the CCAA. In a practical and common sense way, Justice Forsyth interpreted Section 11 of the CCAA in a manner consistent with the overall purpose of the CCAA and concluded that the Court had the jurisdiction and power to stay contractual rights of parties who were not even creditors of the debtor company, where the exercise of contractual rights by non-creditors could jeopardize a successful restructuring under the CCAA. Those principles of interpretation have now been followed by Courts in other provinces of Canada and this decision has been cited in at least twelve other reported decisions in CCAA cases across Canada.

A proposed Plan of Arrangement can deal with secured creditors as well as unsecured creditors and the CCAA may be used in conjunction with corporate legislation to propose a Plan of Arrangement with the shareholders of the debtor company. A Plan of Arrangement is now able to include claims made against the directors of the debtor company. Prior to the 1997 amendments to the CCAA, there was a significant condition that a company had to meet in order to qualify for relief under the CCAA, namely that the debtor company have an outstanding issue of secured or unsecured bonds, debentures, debenture stock or other evidences of indebtedness ... issued under a trust deed or other instrument.

Creditors vote in separate classes according to their similarity of interests, (for example, all secured creditors may vote as one class and all unsecured creditors may vote in another). Voting provisions in the CCAA now mirror those of *the Bankruptcy and Insolvency Act* (the "BIA"). This means that creditors representing a majority in number and 2/3 in dollar value of all creditors in the class voting in person or by proxy will need to accept the proposed restructuring or Plan of Arrangement in order for the restructuring to proceed.

Once the Plan of Arrangement is approved by the requisite majority of each class of creditors and is sanctioned by the Court, the plan will be binding on all creditors dealt with under the plan.

Applicability of the CCAA

The CCAA applies to companies that are incorporated under the legislature of any province or under the *Canada Business Corporations Act*. It can also apply to any non-Canadian corporation that has assets in Canada or is doing business in Canada regardless of where that company was incorporated. For example, a U.S. corporation carrying on business in Canada could apply for relief under the CCAA with or without making a simultaneous filing under Chapter 11 of the U.S. Bankruptcy Code. In fact, we have recently witnessed in Alberta, a successful restructuring case known as Solv-Ex Corporation where the CCAA and Chapter 11 of the U.S. Bankruptcy Code were used simultaneously. In these proceedings there were 12 joint hearings between the U.S. Bankruptcy Court at New Mexico and the Court of Queen's Bench of Alberta at Calgary acting under the CCAA. The *Solv-Ex Corporation* case is a leading example of and precedent for cross-border cooperation in insolvency proceedings.

In order to apply for relief under the CCAA, the debtor company must:

a. be bankrupt or insolvent and admit to its insolvency in its application;

b. have committed an act of bankruptcy within the meaning of the BIA, or is deemed insolvent within the meaning of the *Winding-up and Restructuring Act*;

c. have made an authorized assignment or against which a receiving order has been made under the BIA; or

d. be in the course of being wound up under the *Winding-up and Restructuring Act* because the company is insolvent.

Generally speaking, a company is considered to be insolvent if the company is unable to meet its obligations as they become due or if the fair value of the company's assets are less than its liabilities.

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The Role of the Monitor

Where a stay Order is granted under Section 11 of the CCAA, the appointment of a Monitor is mandatory. The Monitor does not have to be a licensed Trustee in Bankruptcy, but our experience has shown that generally speaking, only licensed Trustees in Bankruptcy are appointed as Monitors in CCAA proceedings. The accounting firm which acts as auditor of the debtor company is eligible to act as Monitor. The Monitor has the following rights and duties:

a. in order to properly assess the debtor company's business and financial affairs, the Monitor is given access to the debtor company's property, including the premises, books, records, data and other financial documents of the company;

b. the Monitor must file a report with the Court on the state of the debtor company's business and financial affairs and the Court usually orders that the Monitor provide reports to the Court on a monthly or quarterly basis until the creditors have voted on the Plan of Arrangement;

c. the Monitor must file a report with the Court forthwith after ascertaining any material adverse change in the company's projected cash flow or financial circumstances;

d. the Monitor must carry out such other functions in relation to the company as the Court may direct. For example, the Monitor may be directed to assist the company in devising a Plan of Arrangement for consideration by the creditors.

Where the Monitor acts in good faith and takes reasonable care in preparing his reports, the Monitor will not be liable for loss or damage to any person resulting from that person's reliance on the report.

The debtor company is required to provide such assistance to the Monitor as is necessary to enable the Monitor to adequately carry out its functions.

Where a Monitor carries on business of a debtor company or continues the employment of the company's employees, the Monitor will not be personally liable in respect of any claim against the company where the claim arose before or upon the Monitor's appointment. In addition, the Monitor is not personally responsible for any environmental damage which occurs before or after the Monitor's appointment unless it is established that the damage occurred as a result of the Monitor's gross negligence or willful misconduct.

The Creditor's Committee

The CCAA does not require the Court to appoint a Creditor's Committee during the CCAA proceedings, however experience has shown that it is often beneficial to all parties to have a Creditor's Committee appointed by the Court to act as a sounding board for the debtor company and the Monitor during the CCAA proceedings. Generally the Creditor's Committee will be representatives of the secured and unsecured creditors comprised of who will meet on a regular basis to hear reports with respect to the status of the debtor company and its business as well as the proposals being considered as part of a Plan of Arrangement. The typical CCAA order establishing a Creditor's Committee will include the following provisions:

a. the Creditor's Committee shall govern its own affairs by a majority vote;

b. it shall inquire into and receive information from the debtor company and the Monitor regarding the present and perspective financial condition of the debtor company;

c. it shall be at liberty to apply to the Court for advice and directions on 2 clear days notice to all interested parties;

d. it shall receive reimbursement of reasonable out-of-pocket expenses of individual members of the Committee;

e. it shall be provided with draft Plans of Arrangement and a reasonable opportunity to comment on such drafts.

Debtor In Possession Financing

There is nothing in the CCAA with respect to debtor in possession financing (commonly referred to as "DIP Financing"). In many CCAA cases, there is a chronic need to obtain interim operating financing to keep the debtor company in business. DIP Financing will only be provided by a lender if that lender is assured by way of Court Order that it will have a first ranking security interest and charge on the assets of the debtor company to secure the interim operating financing. Although there is no statutory basis for the approval of DIP Financing, there are now a number of Court precedents for such financing. The Court, when considering an application for approval of DIP Financing, will want to be assured that all interested creditors have been served with notice of the application. In most cases, the DIP Financier will require that any Plan of Arrangement be subject to its approval. It would be preferable to have the CCAA amended to specifically provide for DIP Financing in order to clarify the Court's jurisdiction and the rules which will govern DIP Financing.

Environmental Concerns

Under the CCAA, a claim against a debtor company for costs of remedying any environmental condition or damage affecting real property of the company shall be a claim under the CCAA whether the condition arose or the damage occurred before or after the date in which the proceedings under the CCAA were commenced.

The Act also provides a special priority for claims for environmental cleanup. Any claim by the Federal or a Provincial Government against the debtor company for costs of remedying any environmental condition or damage affecting real property will be secured by a charge on the real property. This charge is enforceable in the same way as a mortgage on real property. This special environmental cleanup charge ranks above any other claim, right or charge against the real property of the debtor company. It has been referred to as being a "super priority" charge on the land.

Contents of the Plan

The type of Plan of Arrangement used by the debtor company will depend to a large extent on the individual circumstances of the debtor company. In the past, some plans have followed a similar pattern and basically provided for the conversion of debt to equity by way of issuance of stock along with the payment of some cash to the creditors.

There have been some reported decisions where the Court has approved plans which simply provided for a sale of assets by the debtor company to a new company in exchange for securities and obligations of the purchaser.

A Plan of Arrangement under CCAA could be used with corporate legislation to facilitate the acquisition of a public corporation by a solvent so-called "White Knight".

There is some doubt whether or not a plan which simply provides for the liquidation of the assets of a debtor company and the distribution of proceeds generated by the liquidation is a plan which can be adopted under the CCAA. The CCAA was created for the purpose of allowing an insolvent company to attempt to remain in business and avoid being liquidated through bankruptcy. If the debtor company wishes to proceed with liquidation, the *Winding-up and Restructuring Act* or the BIA could be used for those purposes. On the other hand, it can be argued that a straight liquidation plan may be successful under the CCAA where the method of liquidation is different in some respect from that which would occur under the *Winding-up and Restructuring Act* or the BIA.

There are significant income tax consequences which must be considered when preparing a plan under the CCAA. For example, it is vital to consider avoidance of the adverse tax consequences arising as a result of any forgiveness of debt issues or any change of control of the debtor company. It is highly recommended that tax advice is sought from the very beginning of the CCAA process. In some cases, a Plan of Arrangement may be devised which will result in significant tax savings for the debtor company which enhances its ability to continue in business.

The plan filed under the CCAA normally includes at least the a detailed description of the proposed changes to the existing following:

a. an information circular which provides an adequate description of the arrangement as it affects all classes of creditors and shareholders (if an arrangement with shareholders is being proposed) and any person who is affected by the plan (i.e. how are the creditors being compromised). It is necessary to ensure that all disclosure requirements under securities and corporate legislation are complied with if a publicly held debtor company is involved;

b. a current balance sheet and the financial statements of the debtor company which should be audited if possible;

c. appraisal evidence with respect to the assets of the debtor company;

d. a description of the relative priorities of creditors (for example, a list of secured creditors and the types of security held) and a general description of the number and amount of claims of unsecured creditors;

e. a description of how the creditors are being classified for the purposes of voting on the plan. The classification of the creditors should be "confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interests." This is known as the "commonality of interest test". If there are problems that arise from the classification, application can be made to the Court for directions.

f. a pro forma balance sheet which presumes approval of the plan;

g. a projected cash flow of the debtor company;

h. a detailed description of the proposed changes to the existing outstanding shares or the share capital of the of the debtor company if any such changes are contemplated under the plan; and

i. a description of how contingent creditor claims will be dealt with.

When creating a Plan of Arrangement, thought should be given to dealing with all creditors in a fair and equal manner so that preference among the creditors is avoided.

Procedural Steps

The following is a summary of the procedural steps under the CCAA:

a. an application is made to the Court (by the debtor company or any creditor or the trustee in bankruptcy or the liquidator of the debtor company) for an Order declaring that the CCAA applies to the debtor company and directing that a Plan of Arrangement be filed by a specified date;

b. at the same time, the Court usually makes an Order staying, for thirty (30) days, all proceedings taken or that might be taken in respect of the debtor company and prohibiting any further actions, proceedings, or suits against the debtor company. The "proceedings" referred to in section 11, are not limited to proceedings by a court or a court official. The Alberta Court of Queen's Bench decisions in *Meridian Developments* and in *Norcen Energy* v. *Oakwood Petroleum* stand for the proposition that the Courts will give a wide interpretation to the word "proceeding";

c. future applications to the Court are usually made and granted extending the stay of proceedings until the Plan of Arrangement is file and voted on;

d. an application is usually made prior to filing the Plan requesting the Court to approve a form of Proof of Claim which is mailed to the creditors for completion and returned by them to establish the amounts of the claims and their status as either secured or unsecured;

e. once the Plan of Arrangement is ready for filing with the Court, an application is made for an Order directing that a meeting of the creditors occur and that a copy of the plan, notice of meeting of creditors, proxy, and voting letter be mailed to each of the creditors at their addresses as listed in the records of the debtor company. The Order may or may not provide that a notice of the meeting of creditors be published in one or more newspapers;

f. a meeting can be held of all creditors together, however, the creditors must vote as separate classes. A majority in number representing two-thirds in value of each class of creditors must approve the plan before it can be sanctioned by the Court;

g. if shareholders are being affected, the required vote for the shareholders will be set out in the specific corporate legislation or the by-laws which apply to the debtor company;

h. if the plan is approved by the creditors, the plan may then be sanctioned by the Court. The Court does not have to sanction the plan even if it has been approved by the required majority of creditors. It is a purely discretionary exercise, and the Court may find that the plan is not economically feasible or in the best interests of all the creditors. The Court must be satisfied that all statutory requirements have been complied with, that there have not been any preference payments or transfers of assets to creditors, that creditors have been properly classified for voting purposes, and that voting procedures were properly followed;

i. any party or shareholder who objects to the Orders or decisions made under the CCAA may apply for leave to appeal under section 13 of the CCAA. The right to appeal is not automatic under CCAA.

Effect on Guarantors and Co-Debtors

The acceptance of a plan by the creditors of the debtor company does not release guarantors from their obligations. In fact, in *Re Keddy Motor Inns* (No. 3), the Court found that strict statutory requirements are not met where a plan includes provisions prohibiting creditors from proceeding against guarantors of indebtedness of the debtor company. However, one should also note the *ex parte* Order granted by Thackray J. in *Re Quintette Coal Ltd.* which enjoined creditors from making demands for payment upon any guarantor of an obligation of the debtor.

Eligible Financial Contracts

The 1997 amendments to the CCAA created a special group of contracts defined as "Eligible Financial Contracts" which were excepted out of the stay of proceedings power given to the Court under Section 11 of the Act. No Order may be made staying or restraining the exercise of any right to terminate or claim any accelerated payment under an Eligible Financial Contract. Section 11.1 (3) permits the setting-off of obligations under a terminated Eligible Financial Contract.

The rationale for creating this special class of contracts as an exception to the stay of proceedings power may be explained by the following quotation:

> "Derivative Contracts have become a key fundamental for the inter-locking financial activities of virtually every major financial and many major non-financial corporations in Canada and should, therefore, not be dealt with in such a manner as to seriously affect their efficiency."

The definition of Eligible Financial Contract is wide enough to include various types of currency and interest rate swap agreements, foreign exchange agreements and commodity swaps. Is the definition wide enough to also apply to oil and gas purchase contracts? It would appear so, as the definition of Eligible Financial Contract includes a "spot, future, forward or other commodity contract".

In other words, a third party who has entered into an oil or gas purchase or sale contract with a debtor company which files for relief under the CCAA would not be stayed from exercising any termination rights under the contract.

Summary

The CCAA has proven to be a flexible and effective tool for carrying out complex restructurings of the financial affairs of insolvent corporations. Liquidation of insolvent corporations results in loss of good will or going concern value, elimination of jobs and usually a low return to secured creditors, let alone any return for the unsecured creditors. In the right circumstances, the CCAA provides an ideal framework to implement a plan which avoids liquidation and is beneficial to all the stakeholders involved. Although there was some concern that the CCAA would be eliminated, in fact, the 1997 amendments have streamlined the provisions of the Act and thereby strengthened its effectiveness.