Plans of reorganization under the *Companies' Creditors Arrangement Act* in Canada - an Overview

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Background

Any large scale restructuring involving insolvent companies in Canada is almost invariably carried out under the *Companies' Creditors Arrangement Act* (the "CCAA"), the Canadian version of Chapter 11 of the US Bankruptcy Code.

The CCAA differs significantly from Chapter 11 in the sense that it contains very little statutory guidance on the technical requirements of a Plan or the Plan process, but practice over the last two decades and related jurisprudence in Canada has resulted in a reasonably predictable and consistent approach to the development and approval of Plans. The one major legal distinction between the CCAA and Chapter 11 is the fact that under Canadian restructuring law, there is no clear right of equitable subordination or cramdown as exists under US law. This in turn means that a Canadian Plan is in some circumstances limited in terms of what can be accomplished with respect to equity or subordinate classes generally, although there is increasing support amongst Canadian practitioners and other commentators for amendments to the CCAA to provide for a limited form of cramdown to address this problem.

Timing

A typical CCAA process tends to be completed much earlier than would its US equivalent. Most cases do not extend for more than 6 months, although there are examples of cases which have lasted for a year or longer.

The Plan, as in the US, is developed later in the case (unless the Plan has been pre-packaged through a pre-filing negotiation process with the significant stakeholders), but once presented to the court and approved for distribution to creditors, the Plan is usually fully approved within two months, and in some circumstances much faster than that. The key steps along the way are as follows:

1. *Procedural hearing*: This is the first application in court following finalization of the Plan by the debtor. It is used to confirm the court's preliminary approval of the content of the Plan (i.e. that the classes contained in it are in accordance with normal practice and not prima-facie objectionable) and to provide directions to the debtor as to the timing for the meetings of creditors, the information to be circulated to the creditors, and the claims and proxy process (unless this has already been addressed in earlier orders). Because the CCAA legislation does not contain a structured claims process, the specific directions on the details of the process and related forms must come from the court in each filing.

2. *Creditor mail out*: The Plan is sent to the affected creditors together with the proof of claim forms (unless previously circulated) and proxy materials, accompanied by an

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information circular prepared by the debtor which sets forth the background to the Plan and related information. This usually occurs within days of the procedural hearing.

3. *Creditors' Meetings*: In Canada, a meeting of creditors for each affected class must be held, usually at a single venue, and in most cases back to back with meetings of other creditor classes (sections 4 and 5). The Act also contemplates the possibility of convening a meeting of shareholders, if appropriate. The time frame between the procedural order and the meetings is usually around 4 weeks, although in situations of urgency the meetings can be held earlier. Creditors in each class must support the Plan by a dual vote representing more than half in number and two-thirds in value of those creditors appearing in person or by proxy at the meetings.

4. *Court Approval*: The order sanctioning the Plan is typically requested within days of the creditor meetings, assuming that any material condition precedent to Plan approval has by that date been satisfied. At the hearing, the court must be satisfied that there has been strict compliance with statutory requirements and previous orders of the court, that nothing has been done which is not authorized by the CCAA, and that the Plan is fair and reasonable (*Re Northland Properties).* There is no automatic bankruptcy under the Act if the Plan is rejected by the creditors or the court.

5. *Plan Effective Date*: This occurs once all of the residual conditions precedent have been satisfied, usually not more than a few days or weeks after court approval and the expiry of relevant appeal periods (although sometimes the transactions contemplated under the Plan will be completed before the appeal period has expired, if there is urgency).

6. *Plan Implementation Date*: The actual payment of creditor claims under the Plan might not occur until one or two months after the Effective Date in order to allow for the claims process to be concluded. If there are significant claims in dispute which might affect the distribution amounts, a longer delay might result, but in most cases the creditor claims are paid earlier in Canada then they are in the US, and Canadian courts are usually supportive of a fairly summary claims dispute adjudication process in order to avoid lengthy delays in payment of creditor dividends. The fact that there is no concept of recovering fraudulent preferences from creditors receiving payments from the debtor in the period leading up to the filing assists in speeding up the distribution process.

There is no "disclosure hearing" in the Canadian process as typically occurs in a US case. In Canadian restructuring cases, there must always be a court appointed Monitor (a licensed trustee in bankruptcy invariably from one of the larger accounting firms) whose role is to supervise the restructuring process on behalf of the affected stakeholders (section 11.7). This role includes monitoring the operations of the debtor during the filing to ensure compliance with the court's orders and assistance with the Plan process, sometimes including the drafting of the Plan itself, but always including the administration of the claims process and the meeting procedure. The form of information circular which accompanies the mailing of the Plan and claims materials to the creditors must be approved by the Monitor who replaces the U.S. disclosure hearing mechanism in that regard, although clearly it is open to a dissenting creditor to object to the

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disclosure made by the debtor to the creditors at the time of the fairness hearing to sanction the Plan.

Plan content

1. *Classes*

The CCAA provides for the concept of separate classes for secured and unsecured creditors, but no specific direction aside from that. There is no concept of "impairment" as exists under US law, nor is there a listing of specific categories of claims and priorities to be considered in the class structure. Accordingly, there is nothing in the statute to prevent a single class Plan or to preclude the creation of many different classes, and in theory the treatment of those classes is entirely up to the debtor. In practice, most Canadian Plans contain one unsecured creditor class and one or more secured creditor classes on a basis which is not much different from what typically occurs in the US. The overriding concern is to avoid a multiplicity of classes for the obvious reason that the more classes there are, the greater the leverage of each class and the lower the chances of Plan success.

With respect to secured creditors, there is no rule of thumb, although secured creditors are typically either kept out of the Plan entirely (because there is only one dominant secured creditor who would have to be placed in a class by itself and would therefore have veto leverage in any event) or grouped in accordance with their priority position (for example, a class of syndicated lenders with similar priority position, although classes of mortgagees, landlords or equipment lessors have sometimes been created).

2. *Substantive Consolidation*

Although not directly addressed in the legislation, there is a general acceptance in Canadian practice for the concept of a procedurally consolidated filing, and there is also acceptance of a consolidated Plan for voting and distribution purposes in appropriate circumstances. Recent examples of consolidated Plans include Dylex, Bramalea and PSI Net to name just a few. The test established by the jurisprudence requires evidence that there is no prejudice to creditors from a substantive consolidation for voting and treatment purposes (usually established by showing that a creditor's liquidation result would be similar in different companies), or that the operations and assets of the affected companies are too inter-connected to make separate Plans sensible or possible.

3. *Special Rules*

The CCAA does not contain mandatory Plan requirements as does Chapter 11, except in very narrow circumstances. The Act does provide for some specific protection for the crown, but nothing like what exists in the US context. Most crown claims can be compromised and are typically included in the unsecured creditor class, provided that they do not include employee related remittance claims owing to the federal crown which must be brought current within 6 months of emergence (section 11.4), and other crown claims made subject to registered security

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(sections 18.2, 18.4 and 18.5) must be classified as secured claims. Statutorily secured crown claims for municipal real estate taxes are also treated separately and are never compromised in a Canadian Plan.

Because of the absence of cramdown rules, a dissenting class cannot be compelled on any basis to accept the relief contemplated for that class under the Plan. However, there is also no "absolute priority" rule as applies in the Chapter 11 concept, and a debtor in Canada therefore has more flexibility in relation to the treatment of the classes created under the Plan.

4. *Non-Debtor Releases*

Another controversial issue arising from Plan content relates to the potential for releases to be sought in Plans to protect directors and other third parties connected to a Plan such as a sponsor or professionals associated with the restructuring. There are some restrictions contained in the CCAA on what can be released in terms of directors and officers, but there is always a tendency to push the envelope on this issue, and in Canada there is to date little or no jurisprudence to provide clarity.

The Act does specifically allow for stays to be granted in favour of directors and officers of a filing debtor for claims against them where those parties are liable in their capacities as directors and officers for company obligations, and for releases of certain claims against them to be included in a Plan, but not if the claims are creditor specific (such as a guarantee) or based on allegations of misrepresentation, fraud or wilful misconduct. The court also has a general discretion to refuse any compromise against directors which is not "fair and reasonable in the circumstances" (section 5.1). There are no provisions in the Act addressing the concept of stays or releases against other categories of non-debtors, although these types of remedies are typically found in most initial orders and Plans.

Plan Proponent

Although there have been very few attempts to rely on the concept, there is a theoretical ability for any stakeholder involved in a CCAA proceedings to file a Plan and, in fact, to instigate an involuntary CCAA proceeding over the objection of a debtor (sections 4 and 5). There is no "exclusivity" concept in the CCAA to ensure that a debtor has an unfettered right to file a Plan for at least some initial period. In practice, however, the debtor is usually able to resist attempts to take away Plan preparation at the early stages of a filing, provided it can demonstrate that the filing is bona-fide and that it has a realistic chance of putting forward a viable Plan if given the opportunity to do so. In Canada, the Monitor can also have a significant role in the preparation of the Plan, and most initial orders in CCAA cases will confirm that the Monitor's duties include that power.

Cross-border Issues

Except for a general provision in the CCAA that contemplates ancillary proceedings in Canada related to foreign proceedings (section 18.6), there are no specific provisions in the Act to

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address the complexities that can arise when a company with a cross-border business seeks insolvency protection. However in practice, Canadian and US courts have been extremely co-operative in devising strategies to address these complexities. The most common device where there is a need for some sort of filing on both sides of the border in North America is to create a court ordered cross-border protocol at the outset of the filings to address those issues. Insofar as joint Plans are concerned, it is usually not possible at the outset of the filing to fully anticipate where the Plan for a cross-border enterprise should be filed, or indeed, if one or two Plans will be required, so the protocols will tend to be relatively silent on this issue or, at least, open to various possibilities.

In practice, there are advantages and disadvantages in any significant filing to driving the restructuring process from one or other or the two jurisdictions. First, of course, the nature of the businesses on each side of the border may dictate a particular result, simply because one side of the business is dominant. However if that analysis is not determinative of the issue, there will often be a difficult debate between advisors on each side of the professional divide before a decision can be made as to what is in the best interests of the debtor.

On the Canadian side, the advantages are primarily related to cost and speed, as the less structured Canadian procedure and less adversarial process, coupled with the devalued Canadian dollar, will usually produce a far quicker and less expensive result for the debtor in a Canadian centred restructuring than would the more complicated and legally rigorous US approach. However, there are some structural differences that can sometimes militate against a Canadian dominant filing. The primary difference is the fact that there is no formal concept of cramdown in Canada, nor is there as yet any acceptance of the theory of equitable subordination except in very limited circumstances. As a result, unless there is a strategy under Canadian corporate law which would permit the debtor to deal with equity on an acceptable basis outside of the CCAA proceedings but in conjunction with them (achievable in many corporate jurisdictions in Canada where there is clear evidence that the old equity has no value as is usually the case), a US dominant filing may be preferable for that reason alone. A class action or security fraud claim can also affect this decision (the Loewen restructuring is a recent example of that phenomenon), since there is no clear ability to subordinate these types of claim under Canadian law, although Canadian courts are starting to recognize the need to do so.

And finally, there is no principle in Canadian restructuring law whereby pre-filing transactions are automatically reviewed for the benefit of creditors as a possible fraudulent preference as occurs under US law.

On the other hand, there are requirements under US law that do not exist in Canada (for example, the need to pay tax claims, and all executory contract arrears for affirmed contracts). In the result, decisions in this context are usually complicated and significant, requiring that advisors weigh a multitude of considerations before reaching a conclusion on whether one jurisdiction or the other should be dominant, whether Plans need to be filed in both jurisdictions, and if so, the degree of linkage between the two Plans.

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In Canada, there seems to be three different types of cross-border solutions which have been implemented:

1. *Side by Side Plans*: This approach is used where there is no logically dominant jurisdiction, or where each jurisdiction is sufficiently significant that it would be inappropriate to ask the court in either jurisdiction to take overall control of the restructuring. Examples of situations where this strategy has been employed include the recent 360 networks restructuring. In this type of scenario, each Plan stands alone (although usually, each Plan would contain as a condition precedent the approval of the Plan in the other jurisdiction, so that neither Plan could be implemented in isolation from the other), and in theory each Plan could contain entirely different relief for the affected creditors.

2. *Joint Plans*: In this scenario, one Plan is presented in one jurisdiction and creditors on both sides of the border are compelled to submit to the jurisdiction in which the Plan is filed. This approach has only rarely been attempted (an example is the Starcom restructuring, where the British Columbia Supreme Court took jurisdiction over a Canadian and US company jointly owning a cross border fibre optic route, and approved a joint Plan for both companies), and only works if a reciprocating order is made under section 304 of the US Bankruptcy Code or section 18.6 of the CCAA to ensure that the subservient jurisdiction accepts the principle that a joint, cross-border Plan is appropriate.

3. *A Dominant Plan*: In this situation, one jurisdiction takes the lead, with the other jurisdiction following with a reduced form of Plan which shadows the positions taken in the lead jurisdiction, or sometimes nothing more than an independent voting mechanism. The subservient Plan or restructuring procedure will deal in a minor way with local issues but not the primary issues which are all addressed in the dominant jurisdiction. Examples include the Loewen and Laidlaw restructurings which are both US dominant, notwithstanding that both companies are originally Canadian, and the Phillips case in which there were two relatively equal Plans originally contemplated, but the Canadian Plan became subservient because of a class action problem which was only capable of solution under principles of U.S. law. All of these cases were directed primarily to the US jurisdiction because of the advantages available under US law in terms of creditor cramdown and/or priority rules for class claims.

360networks - A case study of a recent successful cross-border restructuring

360networks and its affiliated companies in the US and Canada filed for relief simultaneously in Canada and the US in June of 2001 and emerged from protection based on successful stand-alone restructuring Plans approved by creditors in both jurisdictions in the fall of 2002. Two different (but substantially similar) Plans were presented in each jurisdiction and voted upon separately by creditors in each jurisdiction, with each Plan being dependent for approval on the success of the Plan in the other jurisdiction. The considerations leading to this Plan filing strategy included the following:

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1. The size of the business on either side of the border was significant. Although there were more creditors in the US then in Canada (by a ratio of roughly 6 to 1), the asset value on either side of the border was roughly similar. More importantly, the nature of the business was such that the interconnections in terms of common creditors and overlapping contractual arrangements inevitably meant that most issues arose on both sides of the border for the same entities. Solutions needed to be devised to fit both sets of jurisdictional requirements, not just one.

2. The dominant creditor was a Bank syndicate of secured lenders managed out of New York. Those creditors has total debt which far exceeded the value of the assets and their security charged basically all of them in both jurisdictions with the result that no restructuring could be accomplished without their support, thereby creating a US focus from a negotiation viewpoint. However the corporate structure was based upon a Canadian parent company for which all of the Canadian and US companies in the group were either direct or indirect subsidiaries. Also, the Plan needed to take into account the Canadian corporate and regulatory landscape, which included the requirement of continued Canadian ownership of at least some of the telecom related assets in the business.

3. In the US, the Creditors' Committee was aggressively pursuing its remedies, and was interested in seeking recoveries from various suppliers who had received payments from 360 in the period leading up to the filing. Those recoveries could only be achieved under a US Plan. However, the restructuring required a debt/equity exchange based upon the issuance of debt in a newly created Canadian company that could only be accomplished under Canadian law.

There were obviously a number of other considerations pushing the restructuring in different directions, but in the end it was decided that the most appropriate strategy was to file a substantively similar Plan in each jurisdiction with was linked to the other, but which still took advantage of the jurisdictional differences which benefited the debtor. Accordingly, the US Plan included a provision whereby recoveries from third parties from fraudulent preference actions were pursued and preserved for US creditors only, and the Canadian Plan included a somewhat complicated corporate arrangement procedure involving the Canadian parent company that was available under the applicable Canadian corporate statute. It was also decided to waive any right that might have existed under Canadian law to compromise arrears outstanding under executory contracts being assumed by the debtor to ensure that contract holders on either side of the border received equal treatment.

Although the Plans were separate, each was dependent upon the approval of the other, and both relied upon a common pool of equity for purposes of compromising claims. There was also an attempt to reconcile the release provisions in each Plan, notwithstanding the fact that a broader form of release appeared to be achievable under US law than was achievable in Canada. The use of a common pool required some negotiation with the Committee on behalf of the US creditors, and the Monitor on behalf of Canadian creditors, at a time when the actual amount of debt in both jurisdictions was unclear and therefore it was not possible to do the split based on certainty

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as to its ultimate fairness. Accordingly, the equity and monetary amounts allocated to each jurisdiction were based on estimated claim amounts that fortunately came in much as predicted.

There was also no requirement to convene a single joint court hearing in the US and Canada notwithstanding the complexity of the restructuring and the fact that joint hearings were contemplated by the protocol on an as needed basis. Because the US process was longer in terms of the technical requirements for notice and scheduling, 360 found as the file proceeded that it would invariably apply first in Canada for the required relief, obtaining an order which was contingent for its binding effect on a similar order being subsequently granted in the US proceeding. A similar approach was taken to the Plans, which were voted on and approved first in Canada before being reciprocally approved in the US.

The end result is a successful and fully integrated cross-border restructuring in which both jurisdictions were fully engaged, a relatively uncommon occurrence.

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