BANKRUPTCY AND INSOLVENCY
BASICS FOR LAWYERS

GENERAL OVERVIEW
OF BANKRUPTCY AND INSOLVENCY LAW

These materials were prepared by Geoffrey H. Dabbs of Gehlen Dabbs, Vancouver, B.C., for the Continuing Legal Education Society of British Columbia, February, 2011.

GENERAL OVERVIEW OF BANKRUPTCY AND INSOLVENCY LAW

I. Overview

A. Insolvency
   1. Equity insolvency
   2. Balance sheet insolvency
B. Receivership
C. Bankruptcy
D. Bankruptcy protection
   1. Under the *Bankruptcy and Insolvency Act*
   2. Under the *Companies Creditors Arrangement Act*

II. Receivership

A. Overview
B. Section 244 Notice
C. Court-appointment
D. Model receivership order

III. Bankruptcy

A. Overview
B. Seeking a bankruptcy order against a debtor
C. Stay of proceedings
D. Property of the bankrupt
E. Exempt property
F. Priorities and distribution of the estate
   1. Impact of bankruptcy on priorities
   2. Priorities in a bankruptcy
G. Making a claim against the estate
H. Discharge

IV. Bankruptcy protection under the *Bankruptcy and Insolvency Act*

A. Overview
B. Notice of Intention to Make a Proposal
C. Obligations to notify and file
D. Proposal
E. Meeting of creditors and court approval
F. Default under the proposal
G. Consumer proposal

V. Bankruptcy protection under the *Companies Creditors Arrangement Act*

A. Overview
B. Initial court application and model order
C. Plan of arrangement

VI. Other Statutes

A. *Winding-Up and Restructuring Act*
B. *Farm Debt Mediation Act*

I. Overview

A. Insolvency

The starting point for understanding bankruptcy and insolvency law is understanding the terminology. Too often critical terms are used incorrectly and in a way which only adds to the confusion.

By understanding the key terms, you will more quickly understand the insolvency process and be able to identify the issues that may arise.

1. Equity insolvency

The starting point is "insolvency". What is it and what does it mean?

Black's Law Dictionary (Eighth edition) defines "insolvency" as:

> *1. The condition of being unable to pay debts as they fall due or in the usual course of business.*
>
> *2. The inability to pay debts as they mature – also termed 'failure to meet obligations'…*

That definition is often referred to as "equity" insolvency.

It simply means that a debtor, whether a corporate entity or an individual, cannot meet their obligations as they fall due. It therefore relates to the income or cash flow of the debtor and is not necessarily related to what they own or what their net worth may be.

For companies this is confirmed by section 1 of the *Business Corporations Act* of British Columbia, which provides that a company is "insolvent" if it is "unable to pay the company's debts as they become due in the ordinary course of its business".

All of these concepts are also confirmed in section 2 of the *Bankruptcy and Insolvency Act* of Canada ("*BIA*"), which defines an "insolvent person" (thus being either a corporate entity or an individual) as someone:

> *(a) who is for any reason unable to meet his obligations as they generally become due,*
>
> *(b) who has ceased paying his current obligations in the ordinary course of business as they generally become due…*

Insolvency therefore is a recognition of the debtor's ability to pay debts or not. Insolvency is not a formal legal status.

On the other hand, as will be discussed below, the terms "bankruptcy" and "receivership" describe a formal legal status of the debtor that is the result of the insolvency of the debtor.

Too often all of these terms are treated on the same footing. Knowing the difference allows you to understand the process.

2. Balance sheet insolvency

Another measure of insolvency is often referred to "balance sheet" insolvency. Simply put, it arises when the debtor's liabilities exceed the debtor's assets.

This is also included in the definition of "insolvent person" in section 2 of the *BIA*, being someone:

> *(c) the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due…*

So this definition of insolvency relates to the net worth of the debtor.

In every situation when determining whether a debtor is insolvent, you must consider both definitions of insolvency because they impact on each other. It may be that one is more relevant under the circumstance than the other but again they cannot be considered in isolation.

B. Receivership

Receivership is a formal legal state of an insolvent debtor where a receiver is appointed over the assets of the debtor. Receivership arises at the hands of a creditor, usually who holds security over those assets. Receivership can be granted voluntarily by the debtor or the creditor can seek a court appointment of a receiver.

Likewise, *Black's Law Dictionary (Eighth edition)* defines "receivership" as:

> *1. The state or condition of being in the control of a receiver.*

The role of the receiver is to bring in the assets of the debtor with a view to realizing their net worth so that the secured creditor may be paid what it is owed.

Section 64(1) of the *Personal Property Security Act* of British Columbia provides that a receiver must be licensed as a trustee under the BIA.

It is important to note however that a receiver does not take any authority from nor have the same obligations as a trustee under the BIA. This is yet another example of the importance of using the appropriate terms in the correct context.

C. Bankruptcy

Bankruptcy is a formal legal state of an insolvent debtor where there is an assignment of their assets to a trustee in bankruptcy by operation of the *BIA*, whether voluntarily or by court order. The purpose of that assignment is to then allow the trustee to liquidate the assets so that the creditors may hopefully be paid some amount in a fair and orderly manner.

Specifically, section 2 of the *BIA* defines *"*bankruptcy" as "*…the state of being bankrupt or the fact of becoming bankrupt…"* and "bankrupt" as *"…a person who has made an assignment or against whom a bankruptcy order has been made or the legal status of that person*".

Upon bankruptcy, the trustee is automatically appointed.

Again, those terms refer to the formal legal state of the insolvent debtor.

D. Bankruptcy protection

Under the *BIA* and under the *Companies' Creditors Arrangement Act* of Canada ("*CCAA*") an insolvent

debtor may invoke bankruptcy protection as a temporary means of allowing the debtor to present a proposal to the creditors, to be voted upon by the creditors, as a means of preventing the bankruptcy of the debtor.

1. Under the *BIA*

Proposals are dealt with under Part III of the *BIA*, under which there are two distinct divisions, being Division 1, which provides the general scheme for proposals by commercial enterprises, and Division 2, which provides for consumer proposals. Each division has numerous distinct provisions.

2. Under the *CCAA*

The *CCAA* applies only to a corporate entity with more than $5.0 million of debt and likewise is intended for larger scale bankruptcy protection and reorganizations. The *CCAA* is invoked by the insolvent debtor through court proceedings.

Although much of the *CCAA* mirrors its counterpart provisions in the *BIA*, the *CCAA* nevertheless provides much greater flexibility because the proceedings are supervised by the court and because the court has fairly broad discretionary powers.

II. Receivership

A. Overview

A receiver is appointed, generally by a secured creditor, to take possession of the insolvent debtor's assets for the purposes of protecting the interest of the secured creditor in those assets. The receiver will then realize on the assets firstly to the credit of that secured creditor.

That appointment is typically pursuant to a general security agreement which grants a security interest over the entirety of the "personal" (i.e. non-real estate) property of the debtor, or a mortgage, which grants security over the real estate of the debtor. A secured creditor will typically have both types of security.

The receiver's duties are primarily to the secured creditor. In addition however, specifically in the context of a receivership involving the personal property of the debtor, section 68(2) of the *Personal Property Security Act* will apply, which provides that all rights, duties or obligations of a receiver shall be exercised or discharged in good faith and in a commercially reasonable manner. This is confirmed by section 247 of the *BIA*, which provides for the same thing.

Likewise, whilst the primary obligations of the receiver are to the secured creditor, the receiver must also seek to protect the interests of all stakeholders, including by maximizing the recovery of all assets and by trying to get the best possible price for them (see *Peat Marwick Ltd. v. Consumers' Gas Co.,* [1980] O.J. No. 3669 (C.A.).

Note: a receiver that is appointed over the entirety of the business of the debtor and that is given the mandate to run the business of the debtor is known as a receiver-manager. For the purposes of this paper, term "receiver" will thus include a receiver-manager.

B. Section 244 Notice

A critical aspect to keep in mind is the requirement under section 244 of the *BIA* to give 10 days' advance

notice, in the prescribed form, of the intention to realize upon security in certain circumstances, including through the appointment of a receiver.

This is a landmine for lawyers advising their clients. It is not at all obvious that this provision of the *BIA*, as well as others, would apply to the appointment of a receiver where there is otherwise not a bankruptcy or other apparent involvement of federal law under the *BIA*.

Sections 244(1) and (2) provide as follows:

> *(1) A secured creditor who intends to enforce a security on all or substantially all of*
>
> *(a) The inventory*
> *(b) The accounts receivable, or*
> *(c) The other property*
>
> *of an insolvent person that was acquired for, or is used in relation to, a business carried on by the insolvent person shall send to that insolvent person, in the prescribed form and manner, a notice of that intention.*
>
> *(2) Where a notice is required to be sent under subsection (1), the secured creditor shall not enforce the security in respect of which the notice is required until the expiry of ten days after sending notice, unless the insolvent person consents to an earlier enforcement of the security.*

Likewise, there are a number of considerations when trying to determine whether a section 244 notice is needed.

Typically however, where the secured creditor has a general security agreement over all present and after-acquired personal property of the debtor, the notice will be required pursuant to section 244(1)(c), which is the catch-all part of that section.

The prescribed form under the *BIA* is Form 86, a copy of which is attached to this paper as Appendix "A".

C. Court-appointment

Wherever the debtor will not voluntarily agree to the appointment of a receiver, or simply where the secured creditor wishes for the receiver to have greater powers, a secured creditor may apply to the court for an order appointing a receiver.

Under British Columbia law, Rule 10-2 of the Supreme Court Civil Rules and section 36 of the *Law and Equity Act* each provide for the appointment of a receiver.

There is also the authority in the *BIA* to appoint an interim receiver (sections 46 to 47) or a receiver generally (section 243). The use of those provisions would normally be restricted to the situation where the debtor has a presence in several provinces and needs the authority of a court order that has national effect.

The appointment of a receiver is normally done on an interlocutory basis and likewise the court will do so if it is just and convenient. In the situation involving an insolvent debtor, this will typically mean that the secured creditor will need to demonstrate some jeopardy that will come to the assets if a receiver is not appointed (see *Toronto Dominion Bank v. First Canadian Land Corp.* (1989), 77 C.B.R. (N.S.) 189 (BCSC) and *Tim v. Lai*, [1984] B.C.J. No. 381 (S.C.)).

D. Model receivership order

In 2007, the Supreme Court of British Columbia implemented a model receivership order. That model was confirmed again in Practice Direction 16 issued on July 1, 2010 (for copies of each see: http://www.courts.gov.bc.ca/supreme_court).

That Practice Direction provides that unless the relief sought differs from the model, the model must be used at first instance. If the applicant wishes to seek relief that is different, the applicant must identify the difference by providing a black line copy of the order sought as compared with the model and the applicant must explain to the court the basis upon which it should grant terms that differ from the model.

Under the model, the receiver is given the authority to take possession of the assets, manage the business, engage consultants, purchase equipment, collect receivables, initiate proceedings, sell the assets (subject to further court approval), apply for vesting orders and generally take all incidental steps.

III. Bankruptcy

A. Overview

The primary objective of the *BIA* is to provide for a fair and orderly distribution of the property of an insolvent person amongst that person's creditors.

This is achieved by the *BIA* through the automatic assignment to a bankruptcy trustee of all of the property of the insolvent person (section 71(2)), subject to certain exemptions (section 67(1)(b)). That person is at that moment put into the formal state of bankruptcy (sections 43, 49 and 67 of the *BIA*).

That bankruptcy can result from any of the following:

(a) the debtor making a voluntary assignment into bankruptcy (section 49);

(b) the debtor committing an act of bankruptcy and being petitioned into bankruptcy by a creditor (sections 42 and 43) (described in more detail below);

(c) the creditors voting against a proposal of the debtor under Division 1 (section 57); or

(d) the debtor not abiding by the terms of an approved Division I Proposal and the trustee or a creditor then applying to court to have the debtor deemed bankrupt (section 63).

B. Seeking a bankruptcy order against a debtor

A creditor may commence a proceeding by petition in the Supreme Court and seek a bankruptcy order against a debtor where:

(a) the creditor is owed more than $1,000.00 on an unsecured basis; or

(b) the debtor has committed an act of bankruptcy.

There are numerous acts of bankruptcy (section 42(1)). The most typical ones however, upon which a creditor would seek a bankruptcy order, are where the debtor has ceased to meet the debtor's liabilities

generally as they become due (section 42(1)(j)) or where the debtor has made a fraudulent transfer of the debtor's property (section 42(1)(b)).

C. Stay of proceedings

Whether the bankrupt is petitioned into bankruptcy or makes an assignment, upon bankruptcy there is an automatic stay of proceedings against the estate of the bankrupt (section 69.3). The primary purpose of this is to ensure that the trustee has complete control over all of the assets of the bankrupt's estate so that the estate may be dealt with in an orderly way.

The stay of proceedings only applies to unsecured creditors. Secured creditors on the other hand may proceed to realize upon their security without interference by the trustee (section 69.3(2)). The secured creditor is stayed however from taking proceedings to enforce a personal claim against the bankrupt. The reasoning behind this is to provide the measure of protection to secured creditors that they bargained for when they obtained their security. Likewise, in general, the BIA is intended to provide an orderly distribution only to the unsecured creditors out of assets that are not otherwise subject to legitimate security interests.

A creditor may apply to court for an order "lifting" the stay of proceedings (section 69.4). The creditor must show that the creditor will be materially prejudiced by the continuation of the stay or that it is equitable on other grounds to lift the stay. This is an unusual thing because normally there is no reason to interfere with the ordinary rules of the bankruptcy. However, there are numerous examples of when the stay may be lifted, such as where the creditor is required to obtain judgment in a motor vehicle action in order to establish liability to an insurer (see *Re Buchanan* (2007), 32 C.B.R. (5th) 1 (NSCA)).

D. Property of the bankrupt

Once bankruptcy proceedings have begun, the trustee will gather in all of the assets of the bankrupt in order that they can be liquidated and the proceeds of sale distributed amongst the creditors of the bankrupt as they are entitled.

The property of the bankrupt that is divisible amongst the bankrupt's creditors includes any property that the bankrupt beneficially owns at the date of bankruptcy or that may devolve upon the bankrupt prior to discharge from bankruptcy (sections 67(1)(c) and (d)).

E. Exempt property

Certain of the property of the bankrupt is not however divisible among the bankrupt's creditors, including the following:

(a) property held by the bankrupt in trust for any other person (section 67(1)(a));

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides (section 67(1)(b)); and

(c) property in a registered retirement savings plan or a registered retirement income fund, other than property contributed to any such plan or fund in the 12 months before the date of bankruptcy (section 67(1)(b.3).

In British Columbia, the above exemptions under section 67(1)(b) of the *BIA* (i.e. those available under provincial law) are generally set out in sections 71 and 71.1 of the *Court Order Enforcement Act* of British Columbia and in sections 1 to 3 of the *Court Order Enforcement Exemption Regulation*. The exemptions thereunder are available to individuals and are as follows:

(a) necessary clothing of the bankrupt and the bankrupt's dependants;

(b) household furnishings and appliances that are of a value not exceeding $4,000.00;

(c) one motor vehicle that is of a value not exceeding $5,000.00 or $2,000.00 if the bankrupt is paying maintenance and support under the *Family Maintenance Enforcement Act*;

(d) tools and other personal property of the bankrupt not exceeding $10,000.00, that are used by the bankrupt to earn income from the bankrupt's occupation;

(e) medical and dental aids that are required by the bankrupt and the bankrupt's dependants; and

(f) equity in the bankrupt's principal residence of up to $12,000 if the debtor lives in Greater Vancouver and $9,000 if the debtor lives outside of Greater Vancouver.

A critical case to now consider regarding the exemption for a motor vehicle and for equity in the principal residence is *Re Thow*, 2010 BCSC 1561. That case appears to have changed how these exemptions are interpreted. The court held that the bankrupt was not entitled to the motor vehicle exemption because the vehicle had a value in excess of $5,000. In making this ruling, the Court appears to have overlooked s. 71.2(3), which provides that after the sale of property with a value that exceeds the applicable exemption, the proceeds of sale are to be paid firstly to any secured creditors and secondly to the debtor in an amount not exceeding the exemption.

There is a less commonly known exemption under section 54 of the *Insurance Act* of British Columbia for an insurance-based annuity. Where a spouse, child, grandchild or parent is designated as a beneficiary, such annuities are exempt from seizure by creditors of the holder. This provincial exemption is also maintained in bankruptcy by virtue of section 67(1)(b) of the *BIA*.

There are no exemptions available for a corporate bankrupt.

F. Priorities and distribution of the estate

The priority of a creditor's claim is critical because of course there are not enough assets to go around. It is not simply a matter of being owed money by the bankrupt since even entirely valid and uncontroversial claims against the bankrupt may not be paid. Where a creditor stands on the priorities ladder will often decide whether or not the creditor gets paid at all.

1. Impact of bankruptcy on priorities

Bankruptcy itself changes priorities between creditors because it reverses a multitude of both federally and provincially created priorities. Parliament has such exclusive jurisdiction in bankruptcy and insolvency matters (*Husky Oil Operations Ltd. v. Minister of National Revenue* (1993), 22 C.B.R. (3d) 153 (Sask. C.A.); affirmed 35 C.B.R. (3d) 1 (S.C.C.)), and has used bankruptcy legislation to re-arrange priorities in this regard.

The goal of this re-arranging is usually to level the playing field between creditors. Perhaps the best example is the multitude of federal and provincial statutes that create "super priority" for favoured claims, such as the *Social Service Tax Act* for PST, the *Excise Tax Act* for GST, or the *Employment Standards Act* for unpaid wages. Under the *Bankruptcy and Insolvency Act* ("*BIA*"), particularly sections 86(1) and 67(2), in a bankruptcy most such claims are stripped of their special priority and demoted to "ordinary" or unsecured creditor status.

This creates opportunities for a creditor to use bankruptcy to improve its position. Where a debtor owes a significant tax debt, which by statute has priority over other creditors, then pushing the debtor into bankruptcy can have the beneficial effect of forcing that tax claim to share with the other creditors, rather than being paid first. It is not improper for a creditor to bankrupt a debtor for the purpose of rearranging priorities to suit that creditor: *Bank of Montreal v. Scott Road Enterprises Ltd.* (1989), 73 C.B.R. (N.S.) 273 (B.C.C.A.).

2. Priorities in a bankruptcy

Once in bankruptcy, there is a hierarchy of priorities, starting with the most favoured claims and descending to the most cursed.

With that said, it is difficult to set out a single linear description of bankruptcy priorities because in some cases certain claims are against different types of property and would never actually compete with each other for priority, while in other cases the priority pecking order ends up being circular.

Despite this, the following is an attempt to set out a general hierarchy of priorities:

(a) Section 81.1 of the *BIA* creates a superpriority for unpaid suppliers of goods by allowing the supplier to demand the return of the goods from the trustee. There are strict conditions however on the supplier's right to do so, namely, the goods must have been delivered within 30 days of the bankruptcy, must be in their original state, must not be comingled with other goods, and must not have been sold to an arm's length purchaser. As well, the supplier must deliver the prescribed form of notice to the trustee within 15 days of the bankruptcy. Not surprisingly, meeting the conditions for this priority is not always possible.

(b) Similar to the unpaid supplier priority, unpaid farmers, fishermen and aquaculturists who have supplied products to the bankrupt have the right to a charge over the inventory of the bankrupt under section 81.2. This priority is similar to the unpaid supplier priority such that its timeline and conditions can be difficult to meet.

(c) By virtue of the combination of sections 67(3) and 86(3) of the *BIA* as well as sections 224(1.2), (1.3) and 227(4) and (4.1) of the *Income Tax Act* and other federal legislation dealing with CPP and EI, amounts owing to the Crown for source deductions are granted a super-priority over most other claims of creditors.

(d) The *Wage Earner Protection Program Act* of Canada ("WEPPA") provides a fund to pay wages of employees of a bankrupt employer, up to the amount of $3,000 (or four times the worker's maximum EI insurable earnings, whichever is greater). There is then a corresponding charge on the bankrupt's current assets to secure these payments under sections 81.3 and 81.4 of the *BIA*. For some odd reason, that charge is however only up to a maximum of $2,000.00.

(e) Unpaid pension contributions under *WEPPA* enjoy a priority status that is secured by a charge against all assets of the bankrupt.

(f) Secured creditors come next. They are to a large extent outside the ambit of the *BIA* (of course subject to being behind the above super-priority charges). The overall policy of the bankruptcy regime is to allow secured creditors to pursue their secured rights and essentially ignore the bankruptcy. This is provided by section 136 of the *BIA*, which is the main section dealing with priorities in bankruptcy, which opens with: "Subject to the rights of secured creditors….".

(g) Section 136 then goes on to provide for a hierarchy of "preferred claims", being after secured but before unsecured. Those preferred claims include:

i. funeral expenses of the deceased bankrupt,
ii. costs of administration of the bankrupt estate, including the trustee's fees,
iii. the levy payable to the Superintendent of Bankruptcy for each bankrupt estate,
iv. maintenance and support payments,
v. municipal taxes,
vi. the claims of landlords under a lease for up to three months of rent arrears and up to three months of accelerated rent following the bankruptcy, and
vii. various other unusual claims.

(h) Then comes ordinary, being unsecured, claims.

G. Making a claim against estate

Sections 121 to 135 of the *BIA* deal generally with how a creditor may make a claim against the bankrupt's estate and how the trustee is to assess and handle those claims.

The process begins with the trustee sending out a statutorily prescribed proof of claim form to each of the creditors so that they may set out how much they are owed and the particulars of their claim. The trustee will then vet the claim and determine whether the claim is valid or whether the claim, or part of it, should be disallowed.

If the trustee disallows an unsecured claim, the creditor has a right to appeal the disallowance to the court within 30 days under section 135(4). That appeal is a true appeal and not a hearing *de novo* (*Re Galaxy Sports Inc.* (2004), 1 C.B.R. (5th) 20 (BCCA)).

Where a person claims a specific interest in property of the bankrupt, that person must provide the trustee with a proof of claim (property) under section 81 of the BIA. If the trustee disallows that proprietary claim, the creditor has a right to appeal to the court within 15 days.

H. Discharge from bankruptcy

An individual bankrupt is entitled to be discharged from bankruptcy. That process is set out in sections 168.1 to 182 of the *BIA*. A corporate bankrupt may only seek a discharge if its debts are paid in full.

The ultimate purpose of a discharge from bankruptcy is to release the bankrupt of the claims of creditors that existed at the date of bankruptcy, pursuant to section 178(2) of the *BIA*. There are numerous claims that are however, for a variety of public policy and other considerations, not released by the discharge of the bankrupt, pursuant to section 178(1) of the *BIA*.

In deciding whether to grant the bankrupt a discharge or whether to impose terms or conditions upon which the discharge is to be granted, the courts balance a number of often conflicting considerations.

For example, the court does not wish to see the bankruptcy process being used as a clearing house for the bankrupt's debts or in a manner that would otherwise offend commercial reality (*Re Irwin* (1994), 24 C.B.R. (3d) 211 (BCCA)).

The court however does not wish to prevent a bankrupt from overcoming what may otherwise be an insurmountable burden of debt, which of course was the very reason for the bankruptcy in the first place. In *Re Murray v. Denson* (1971) 2 W.W.R. 548 (BCSC), the court held:

> *One of the prime purposes of the Act is to permit an honest but unfortunate debtor to obtain a discharge from his debts subject to reasonable conditions. The Act is designed to permit a bankrupt to receive eventually a complete discharge of all his debts in order that he may be able to integrate himself into the business life of the country as a useful citizen free from the crushing burden of his debts.*

These principles quite clearly mean that there will be a broad range of possibilities that may ensue from the process of discharge from bankruptcy.

IV. Bankruptcy protection under the *Bankruptcy and Insolvency Act*

A. Overview

Under Part III of the *BIA* an insolvent debtor may invoke bankruptcy protection as a temporary means of allowing the debtor to present a proposal to the creditors, to be voted upon by the creditors, as a means of preventing the bankruptcy of the debtor.

Commercial proposals are dealt with under Division I (i.e. sections 50 to 66) of Part III of the *BIA*. Consumer proposals are under Division II (i.e. sections 66.11 to 66.4). This paper will focus primarily on commercial proposals.

The point to the proposal is to offer a compromise to the creditors, which if approved, becomes a legally binding contract between the debtor and the creditors. That will then allow the debtor to stay out of bankruptcy and to carry on the debtor's business. The benefit for the creditors is that the amount received will inevitably be greater than if the debtor had gone bankrupt. That ultimately is the incentive that every proposal must offer to the creditors as a means of securing the creditors' approval.

Under section 50(1) of the *BIA*, a proposal may be filed by, among others, an insolvent person, a receiver of an insolvent person, a bankrupt, or a trustee of a bankrupt.

B. Notice of Intention to Make a Proposal

The process begins with the debtor consulting with a trustee, who then files the proposal with the official receiver at office of the Superintendent of Bankruptcy.

Where a debtor fears immediate action may be taken by a creditor that could affect the debtor's business, the debtor may not have time to prepare and file a proposal. In that case the debtor may file a notice of intention to make a proposal ("NOI") (section 50.4). It is simply a one page document that sets out this intention.

The filing of either a NOI or a proposal invokes an immediate stay of proceedings and thus creditors may not take any further action against the debtor (section 69.1). In most circumstances, a secured creditor will

be stayed as well, unless for example, where the secured creditor has provided its section 244 Notice (see Part II.B of this paper) more than 10 days before the NOI was filed (section 69.1(2)).

The stay of proceedings only applies to claims that exist up to the date of the filing of the NOI. All debts after that date are outside of the process and therefore must be paid immediately or on whatever terms are agreed to by the creditor (section 65.1(4)).

C. Obligations to notify and file

Within 5 days after the NOI is filed, the trustee must notify all creditors (section 50.4(6)).

Within 10 days the trustee must file with the official receiver:

(a) a cash flow statement;

(b) a report on the reasonableness of the cash flow statement prepared and signed by the trustee; and

(c) a representation from the debtor that the cash flow statement is reasonable (section 50.4(2)).

Within 30 days the trustee must file the proposal (section 50.4(8)).

A debtor may apply to court for an extension of the deadline for the proposal but this extension, if granted, may not exceed 45 days. Further extensions may also be sought but in total the extensions may not exceed 5 months (section 50.4(9)).

If the cash flow statement is not filed within 10 days of the NOI or a proposal is not filed within 30 days and no extension has been granted, the debtor will be deemed to have made an assignment into bankruptcy (section 50.4(8)). Likewise, care should be taken to ensure that the timelines are met.

D. Proposal

In most circumstances, proposals are made only to the unsecured creditors as the secured creditors generally operate outside this process given their rights. Likewise, the success of this process usually depends entirely upon the participation and co-operation of the secured creditors. Without it, the process is inevitably pointless. This is because it is unusual for any small or medium size business to have such a number of secured creditors that this process would even be engaged in the first place by having a vote of those creditors. If the business has, for example, only one secured creditor, then that creditor has complete veto power to accept or reject the proposal and likewise the process is academic.

The creditors, both unsecured and secured (as the case may be), may also be dealt with in classes. This is unusual for most small or medium sized businesses.

For unsecured creditors, there is no provision in the BIA that sets out the considerations as to the make-up of the classes. The general rule is that there must be a commonality of interest within the class (*Re Woodward's Ltd.* (1993), 20 C.B.R. (3d) 74 (BCSC)).

For secured creditors, the *BIA* sets out specific criteria, in keeping with that same concept (section 50(1.4)).

E. Meeting of creditors and court approval

Within 21 days of the filing of the proposal a meeting of creditors must be held for the purposes of voting on the proposal (section 51(1)).

As discussed, the creditors may be divided into classes and each class will then vote to accept or refuse the proposal. The proposal must be accepted by all classes of unsecured creditors, in each case by a majority in number of the creditors, representing at least 2/3 of the total dollar value of the debts (section 54(2)(d)) .

If the proposal is refused, the debtor is deemed to have made an assignment into bankruptcy and the trustee then becomes the trustee in bankruptcy (section 57).

If the proposal is accepted, then the trustee must apply to court for its approval (section 58). Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court will refuse to approve the proposal (section 59(2)).

If the court approves the proposal, then all creditors included in the proposal are stayed and are bound by the proposal according to its terms.

F. Default under the proposal

If after court-approval the debtor defaults in the performance of any term of the proposal, and if the default is not waived by the creditors or remedied by the debtor, the trustee is then required to inform the creditors and the official receiver (section 62.1).

The trustee or any creditor then has the right to apply to court for an order that the proposal be annulled. If granted, the debtor is deemed to have made an assignment into bankruptcy (section 63).

When deciding upon whether to grant the annulment, the court will consider the timeliness of the application, the debtor's misconduct, and the benefits to the creditors of an annulment (*Re Garrity* (2006), 25 C.B.R. (5th) 95 (AB QB).

G. Consumer proposal

An individual whose total debts do not exceed $250,000, excluding any mortgage debt on a principal residence, may make a consumer proposal under Division II of Part III of the *BIA* (i.e. sections 66.11 to 66.4).

This is done by obtaining the assistance of an administrator who will assist the consumer with preparing the proposal (section 66.13(1)). In doing so, the administrator is required to investigate the consumer's property and financial affairs and to provide counselling to the consumer (section 66.13(2)).

Like a commercial proposal, there is a stay of proceedings with respect to a consumer proposal, however, it does not include secured creditors (section 69.2).

The proposal is not voted upon unless creditors representing 25% of the total debts request a meeting of creditors for that purpose (section 66.15(2)(b)). If that meeting is not called, the consumer proposal is automatically accepted (section 66.18(1)).

Court approval is not needed unless requested by a creditor. Otherwise, court approval is deemed to have been given (section 66.22).

V. Bankrutpcy protection under the *Companies' Creditors Arrangement Act*

A. Overview

The *CCAA* offers a similar process as the provisions of the BIA dealing with proposals but on a much bigger scale. The *CCAA* can only be invoked by corporate entities with more than $5.0 million of debt and likewise it is intended for larger scale bankruptcy protection and reorganizations.

The *CCAA* is invoked by the insolvent debtor through court proceedings and because of the court's supervision and powers, the *CCAA* provides much greater flexibility than its counterpart provisions in the *BIA*.

B. Initial court application and model order

The process is commenced by a debtor company bringing proceedings by petition in the Supreme Court. Typically, the debtor then sets an interlocutory hearing on an *ex parte* basis, and seeks an "initial" order.

In 2006, the Supreme Court of British Columbia implemented a model *CCAA* initial order. That model was confirmed again in Practice Direction 15 issued on July 1, 2010 (for copies of each see: http://www.courts.gov.bc.ca/supreme_court). As is the case with the model receivership order, that Practice Direction provides that unless the relief sought differs from the model, the model must be used at first instance.

The initial order typically contains the following provisions:

(a) stay of proceedings (pursuant to section 11.02 of the *CCAA*);

(b) appointment of a monitor who is to supervise the restructuring, assist the management of the debtor and to file reports for the court and the creditors (section 11.7);

(c) authority to repudiate leases and other kinds of agreements, subject to conditions (section 32);

(d) authorization of debtor-in-possession financing (section 11.2); and

(e) authorization of priority charges to secure payment of, among other things, fees of the monitor, counsel for the monitor, counsel for the debtor, and a directors' charge on account of statutory or other obligations that may arise post-filing (sections 11.51 and 11.52).

C. Plan of Arrangement

As with a proposal under the BIA, the debtor company under the *CCAA*, with the assistance of the monitor, prepares and presents a plan of arrangement to the creditors (sections 4 and 5).

That plan will of course typically be complex and layered as most companies utilizing the *CCAA* have complex operations. This is again another reason why such companies would prefer the flexibility of court supervision that the *CCAA* offers.

D. Meeting of creditors and court approval

As with a proposal under the BIA, the creditors may be divided into classes and each class will then vote to accept or refuse the proposal. The proposal must be accepted by all classes of creditors, in each case by

a majority in number of the creditors, representing at least 2/3 of the total dollar value of the debts (section 6).

Unlike under the *BIA*, if the creditors do not accept the plan, there is not then an automatic bankruptcy. It is up to the creditors, typically the secured creditors, to then apply for an order lifting the stay of proceedings so that they may then realize upon their security. The practical effect of that will be that the debtor company will likely put into receivership or bankruptcy or both anyway.

If the creditors do accept the plan, the debtor must then seek court approval at a "fairness" hearing (section 6), at which the court will consider the following:

(a) whether the statutory requirements have been met;

(b) whether anything has been done that is not authorized by the *CCAA*;

(c) whether the plan is fair and reasonable (*Re Northlands Properties Ltd.* (1989), 34 B.C.L.R. (2d) 122 (C.A.)).

VI. Other statutes

A. *Winding-Up and Restructuring Act*

The *Winding-Up and Restructuring Act* applies where a regulated corporate entity or body, such as a bank, trust company or insurance company seeks to restructure, as those organizations are typically not eligible to apply under the *CCAA* or file under the *BIA*.

B. *Farm Debt Mediation Act*

Section 21 of the *Farm Debt Mediation Act* requires that a secured creditor of a farmer (which includes corporate entities engaged in farming) must not seek to enforce the security unless the secured creditor gives the farmer the prescribed form of advance written notice at least 15 days in advance.

That notice advises of the farmer's right to seek (from the statutory administrator) a stay of proceedings under section 5.

Under section 7, that stay is then in effect for 30 days. During that time, the farmer can seek to mediate with the secured creditor.