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CCAA Primer: Preserving your rights to collect from distressed companies

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Introduction to the CCAA

The Companies' Creditors Arrangement Act ("**CCAA**") is a Federal Act that intends to give debtors a way out of financial difficulties without necessarily resorting to bankruptcy, a foreclosure or the appointment of a receiver.

The CCAA permits an insolvent company to make arrangements or compromises with its creditors. It also permits the company to restructure (if possible). When a company is under a CCAA filing, it continues to function and maintain control of its assets, albeit under the watchful eye of an independent court-appointed Monitor. The result is one that hopefully maximizes returns to creditors and maintains jobs for employees.

The philosophy behind the CCAA

The CCAA applies to qualifying companies with at least $5 million in claims against them. “Company” is defined in the Act as including those companies incorporated in a Canadian jurisdiction and any company having assets in or doing business in Canada.

The CCAA trumps provincial legislation to the extent of any conflicts in the respective Acts. It is remedial legislation, and as such should be given a large and liberal interpretation.

The terms “insolvent” or “insolvency” are not defined in the CCAA. However, to use the Act one must be insolvent and admit the same. “*Insolvency*” is given a larger interpretation in the CCAA than under the Bankruptcy and Insolvency Act (“**BIA**”). This means that the court will look ahead to some degree to detect a looming crisis. It also means that a company need not wait until a restructuring is financially impossible to apply under the Act.

The CCAA permits arrangements or compromises between an insolvent company and its secured and/or unsecured creditors (or any class of each). A debtor can file a “plan of arrangement” that will enable it to restructure its business and/or obtain financing while remaining functional. This often results in a better return to creditors than in a bankruptcy and also offers some protection to the company's employees.

If an offer or arrangement or compromise is rejected, the company does not automatically become bankrupt. However, certainly there will be considerable pressure on the company if this happens. It is likely that the company will at that point be petitioned into bankruptcy under the BIA, often by the creditor voting against the plan.

The rights of creditors under a CCAA filing cannot be compromised <u>unless</u>:

(a) the creditor has been given the right to vote on the plan;

(b) the creditor's vote has been accorded the proper weight by the court;

(c) the creditor's class has accepted the plan with a majority representing 2/3 of the value of the debt; and, the court has blessed the plan as fair and reasonable.

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How it works

An insolvent company typically applies to the court for CCAA protection in a summary fashion and often on an *ex parte* basis (although some notice should be provided to creditors if time and circumstances permit). Often thereafter, the company or a creditor applies to the court to consider the proposal in a meeting of creditors. A formal plan concerning the compromise arrangements is usually filed at that time.

The court may order a meeting of creditors in response to an application to make a proposal. Or, the court may dismiss the application if there is no reasonable chance that the company will be able to continue its operations and restructure.

Claims against directors that arose prior to the commencement of CCAA proceedings may be compromised in a plan. A stay may be granted in respect of those claims when a proposal is made.

The initial order in a CCAA proceeding sets out such matters. It also appoints a Monitor and outlines its powers and duties.

The proposal may be approved by the court where it has majority support of the creditors or the class representing 2/3 of the value of the claims. It then becomes binding on the creditors or the class of creditors at issue.

The court might reject the proposal if it finds that it is not fair, reasonable to the creditors as a whole and/or and equitable (let alone where it is simply not workable). This is possible even if the majority of the creditors approve the plan.

Generally, for a plan to be sanctioned by the court it must:

(a) comply with all statutory requirements;

(b) be in compliance with all court orders and not purport to do anything not authorized under the CCAA; and

(c) be fair and reasonable.

In determining whether or not a plan is fair and reasonable, the court can look at:

- whether the claims and classes of creditors are proper;
- whether a proper majority approves the plan;
- independent reports of the Monitor and other independent analysis of the assets;
- any other restructuring options that may exist;
- oppression to certain shareholders;
- unfairness to shareholders and;
- public interest (such as the retention of the company as a taxpayer and employer as we see in the press with Chrysler and GM).

If specific amendments are of value to the plan, the court can make them at the time of the meeting with the company and its creditors. The court can also amend plans in exceptional circumstances even after they have been sanctioned.

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The Application and its effects

When an application is made to the court under the CCAA, there is typically a 30 day stay of proceedings or the issuance of new proceedings against that company (and often directors of the same). The purpose of the stay - as defined by the courts - is to maintain the status quo during the proceedings to the benefit of the company and its creditors. The creditors must continue to conduct regular business with the company during the stay but can accelerate payment or demand payment if they have the right to do so (but typically they cannot repossess goods, cancel leases or contracts solely because of the CCAA application).

This stay may be extended for such time as the court deems fit and as long as there is no prejudice to creditors. In order to be granted an extension, the applicant must show it continues to be entitled to an order, to act in good faith and to act with all necessary due diligence and dispatch in formulating a plan. An extension will not be granted where there is no hope to save the company, where the plan is doomed to fail and where the effort is simply to buy time.

The court maintains a very broad discretion to impose any necessary terms and conditions on the stay and any extension of the stay. Breach of a stay order by a creditor amounts to a contempt of court.

A creditor may apply to the court to set aside or vary a stay in the proper circumstances.

In many CCAA proceedings the debtor seeks debtor in possession ("**DIP**") financing to stay afloat, to pay administration charges and contractors, to pay any interim receiver appointed and the Monitor and to effect the completion of a project or the restructuring. This DIP financing may rank ahead of existing lenders at the court's discretion: this is often necessary to entice lenders to provide capital (usually a higher rate of interest).

During the CCAA proceeding, a Monitor is appointed by the court to monitor the company and its business and financial affairs. The Monitor also assists with the filing of and the voting on the plan. Parties must cooperate with the Monitor who reports to the court in advance of any meeting of creditors on the plan. No liability attaches to the Monitor in its role as an independent appointee of the court. Finally, the Monitor does not take possession of the company's assets as in the case of a receiver. If a notice to enforce security has been delivered, then the court may appoint an interim receiver in some cases.

To vote on and to receive a distribution under the plan, the creditor must file a claim. The claim must be provable.

There are several proposed amendments to the CCAA which we will write about in future articles.

In the current economic climate, both CCAA proceedings and bankruptcies are on the rise. This includes unprecedented filings by North American icons and institutions. Knowing your rights as an unsecured or a secured creditor in advance of or even after such proceedings are filed can make all the difference in your businesses recovery rate. It can also protect your business from suffering a similar fate.

Richard Attisha and Christopher Johnston are lawyers practicing in the commercial litigation group at Harper Grey LLP in Vancouver, BC. Questions about CCAA proceedings? Feel free to contact either Richard or Christopher at 604 687 0411. You can also find further information on our website, www.harpergrey.com.

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