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COVID-19 AND INSOLVENCY LAW: WHAT YOU SHOULD KNOW

Introduction - Follow the Breadcrumbs... Down

The COVID-19 pandemic has brought the global economy, and with it, the North American, Canadian, and local economy in Alberta into crisis. Alberta, including its energy sector, has been disproportionately hard hit as a surplus of oil and an inability to get Canadian product to market have met the destruction of demand caused by the pandemic. With governments implementing social distancing, stay-at-home orders and the closing of all non-essential businesses, they have stepped in to provide assistance on national and local levels. But the aid is likely to be inadequate in the face of the fallout.

Because businesses are interconnected, if one follows the breadcrumbs, it's not an exaggeration to say that virtually all business sectors will be affected. The failure of a single local restaurant has a ripple effect: the restaurant's food suppliers lose a customer; one less customer means one less delivery; one less delivery means less demand for fuel, and so on. From transportation to hospitality and tourism, and from construction and commercial leasing to health and wellness services, all businesses are under extreme strain and will likely face serious liquidity crunches and, possibly, insolvency-related challenges. No one is immune.

The bottom line is that the company you direct, manage or own - or you as an individual, employer or guarantor - will likely have to deal with insolvency-related issues in some way. Canadian insolvency law and proceedings can be complex. Here are some key, practical "must-know" take-aways regarding some common issues to help you quickly get your bearings, make plans and address the situation in this climate of extreme uncertainty.

Insolvency 101

Stay of Proceedings: There are two main pieces of legislation that deal with insolvency: the federal *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("**BIA**") and the federal *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 ("**CCAA**"). A core feature of proceedings under the BIA (including Receiverships, bankruptcy, and the Notice of Intention to make a proposal ("**NOI**") under the BIA) and the CCAA is the powerful "stay of proceedings" ("**Stay**") (see ss. 11 and 11.02 of the CCAA, and ss.69 and 69.3 of the BIA, as well as caselaw respecting Receiverships).

Depending upon the type of insolvency proceeding, the Stay works to prevent some or all creditors or claimants from exercising most rights against an insolvent which they otherwise have. If you are an insolvent entity with the benefit of a Stay, the Stay will work to your advantage by stopping some or all creditors and claimants from enforcing against and gaining unequal access to your assets and, if the filing is aimed at a restructuring, a Stay will work to provide some breathing room for you to try to restructure your affairs.

If you are a creditor or claimant in respect of an insolvent, a Stay may work to your detriment by potentially preventing you from taking steps which, prior to the insolvency filing, were otherwise available. A Stay can block the exercise of many contractual rights, which may include the termination of the contract upon non-payment. Further, even though your rights are stayed, you may nonetheless be obliged to continue to supply or perform the contract with the insolvent.

Beware: wrongfully taking steps in the face of a Stay can result in contempt of Court proceedings and/or cost sanctions against you.

Secured Creditors and the Stay: If an insolvent is assigned into bankruptcy or determined by a Court to be bankrupt, the Stay does not affect the rights of secured creditors which may be pursued through the appointment of a Receiver or otherwise (s. 69.3 (2) of the BIA). This is not the case if the insolvent has instead filed an NOI (s. 69(1)) or has obtained an Initial Stay Order under the CCAA (s. 11 and 11.02), both of which allow for a Stay of rights of secured creditors. Secured creditors stayed by NOI or CCAA proceedings may apply to Court to challenge or lift the Stay to permit the enforcement of their security and that relief is discretionary where success can be difficult and depends upon the consideration of various factors (see s. 65.1(6) of the BIA, caselaw under the CCAA).

Unpaid Sellers and the Stay: A Stay doesn't affect all rights. If you or your company are an unpaid supplier to an insolvent company in Receivership or bankruptcy, s. 81.1 of the BIA provides a right for you to repossess certain property delivered if certain criteria are met, including if the goods were delivered within 30 days of the Receivership Order or bankruptcy. If your insolvent company is the buyer and is in one of these insolvency proceedings, you may expect such claims from unpaid suppliers. Caselaw indicates that these rights of unpaid suppliers are not available in the face of a CCAA Stay.

Eligible Financial Contracts ("**EFC**s") and the Stay: EFCs are "derivative agreements" - financial contracts which are specifically defined under the Regulations of the BIA and the CCAA. They are common in the energy sector and include certain swaps, futures agreements and options. A Stay does not prevent the non-insolvent counterparty from exercising contractual rights contained in EFCs, including the right to terminate and set-off. Disputes can arise as to whether particular contracts fall within the statutory definition of EFCs.

Time Sensitive Filings - Builder's Liens and Lawsuits: Normally the Court Order granting any CCAA Stay permits the filing of time sensitive documents which would otherwise be precluded by the Stay. Careful review of the Stay Order is required to assess whether such a filing is possible without Court approval. Sometimes, Court applications need to be brought to seek leave to lift a Stay to permit the taking of steps.

Can I do What My Contract Says I Can?

Ipso Facto Clauses: If your contract contains a provision that, for example, the contract automatically terminates if your counterparty makes an insolvency filing, this clause is actually not enforceable in the event of an insolvency filing (see s. 34 of the CCAA, s. 65.1 of the BIA and the related caselaw.

Letters of Credit: Calls or demands on Letters of Credit are not precluded by a Stay (s. 11.04 of the CCAA and BIA caselaw).

Disclaimer: Receivers, as well as insolvent debtors under an NOI or the CCAA, can determine that it is in the best interests of the insolvent not to honour or perform certain kinds of contracts if they are uneconomic. Upon meeting certain criteria, certain contracts can be disclaimed by notice (see caselaw, s. 32 of the CCAA, and s. 65.11(1) of the CCAA). In this way you, as a solvent counterparty, can have relied on a revenue stream under a contract for example, but receive notice that the contract will no longer be honored or performed. If you receive such a notice it can be challenged in Court. It is imperative to know which contracts are critical to your business and have in mind an appropriate plan in case this materializes.

Set-Off Rights: Energy contracts, including joint venture agreements and other contracts, often contain set-off or netting provisions which allow, as a simple example, Party A to set-off or net such amounts as it owes Party B against sums owed by Party B to Party A. In addition to contractual set-off rights, the law of set-off includes legal and equitable rights of set- off.

While a Stay likely precludes the exercise of any set-off rights without the Court's permission, the CCAA (s. 21) and the BIA (s. 97.3) provide that set-off rights are preserved. However, caselaw has explained that such set-off rights may not always be allowed to be exercised. If you have set-off rights and claims, they need to be carefully assessed in order to know how they can be lawfully advanced.

Must I Extend Credit in a Restructuring?: If, in the face of a Stay pursuant to a CCAA or BIA NOI filing, you, as a claimant or creditor, are prevented from exercising your rights and find yourself having to perform the contract, both the BIA (s. 65.1(4)) and the CCAA (s. 11.01) provide that you are not obliged to extend credit to the insolvent. Arrangements can be negotiated with the insolvent to effectively implement that right. Failure to do so can result in exposure to non-payment.

Can the Stay be Lifted?: The ability to apply to the Court to lift the Stay is not limited to secured creditors. While it can be difficult to succeed, under the BIA (s. 65.1) and the CCAA (caselaw), anyone affected by a Stay may apply to the Court to have the Stay lifted so that rights can be exercised. Under the BIA, the prospects of success depend upon meeting certain criteria while similar criteria are also applied under the CCAA. The application of these criterion needs to be analyzed on a case-by-case basis.

Directors Duties: Directors of companies owe duties to the corporation which they serve (statutes such as the Alberta *Business Corporations Act*, RSA 2000 c B-9, and caselaw). Solvent companies generally orient towards the interests of their shareholders. When a corporation is in the "zone of insolvency" such that shareholders may have no equity, caselaw specifies that directors continue to owe their duties to the corporation but must have particular regard for those claimants with the real stake in the company (i.e. secured and other creditors whose claims legally rank ahead of shareholders). There are many issues that arise for directors which often require careful analysis to ensure compliance with the law.

Preferential and Undervalue Transactions: In general terms, provisions of the BIA (ss. 95, 96) - and other Alberta legislation like the *Fraudulent Preferences Act*, RSA 2000, c F-24 and the *Statute of Elizabeth*, 1571 (UK), 13 Eliz I, c 5 - are aimed at ensuring that, among other things, individuals and companies do not make transfers of their property which wrongfully prefer or advantage certain creditors or others, or serve to wrongfully remove assets from the insolvent's estate. Corporate directors need to be extremely careful to ensure that their company does not act contrary to these laws, including when liquidity is stressed. Knowing exactly what can and cannot be done in these circumstances is imperative. Persons in their individual capacities must also follow these rules.

What to do?

In these times, it is imperative that you understand with clarity the rights you and your organization have so that you are in position to act promptly. Time is always of the essence where liquidity is in issue. Does your organization need and qualify to obtain the benefit of a restructuring insolvency Stay under the BIA or the CCAA? Being able to take this step requires significant advanced planning and a reserve of cash or at least an ability to access interim financing.

If you are a secured creditor, is your security duly registered and capable of being enforced? What is the proposed exit strategy, and will Receivership provide that? Are you ready if your counterparty or commercial tenant or landlord makes an insolvency filing? What will be your response? Do you have a plan B if a critical contract is disclaimed?and 11.02 of the CCAA, and ss.69 and 69.3 of the BIA, as well as caselaw respecting Receiverships).

We at JSS Barristers have in-depth knowledge about insolvency matters across many business sectors. We act on multi-million-dollar national insolvency matters, as well as on smaller insolvency matters with an impact on more local, Alberta interests. As trusted advisors, we take pride in attending to our clients, and their objectives, with the of utmost care. We have a team of lawyers with extensive knowledge ready to assist you to make your way in these highly uncertain times.

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