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• ALTERNATIVE RESTRUCTURINGS: STRATEGIES, CHALLENGES AND PITFALLS •

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I. Introduction

Financially distressed companies seeking to de-leverage their balance sheets and their stake-holders are increasingly looking at creative alternatives to a formal insolvency filing in order to minimize transaction costs and avoid the stigma associated with a formal insolvency process. As a result, out-of-court restructurings and arrangements under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 [*CBCA*], have been steadily gaining in popularity in recent years.

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There is little doubt that the administrative and professional costs of a formal insolvency filing can be crippling to a company at a time when it is already suffering from significant financial strain and is struggling to conserve cash. Equally, if not more problematic to a distressed company, can be the impact of the insolvency filing on its business. A filing under the *Companies' Creditors Arrangement Act* (Canada), R.S.C. 1985, c. C-36 [*CCAA*], or Chapter 11 of the *U.S. Bankruptcy Code* [*Chapter 11*] involves a very public declaration of insolvency. From a business point of view, it is understandable why distressed companies and their stakeholders would be concerned about the negative impact a formal insolvency filing may have on the value of its business. A formal insolvency proceeding can put additional strain on what may already be fragile relationships with key customers and suppliers. It may also put downward pressure on the value of the distressed company's assets and raise the cost of credit available to the distressed company.

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Whether the stigma of bankruptcy is actually more a matter of perception than reality, or whether this stigma can be materially mitigated by a pre-packaged *CCAA/Chapter 11* filing, is subject to debate. However, it is generally acknowledged that customers, suppliers and employees of the filing company will experience some alarm and uncertainty over the short and long-term prospects of the filing company. Will the company come out of the filing? When will this occur? How will the filing affect the company's business relationships with its customers, suppliers and employees? These are all common and legitimate questions and concerns which motivate debtors and their stakeholders to search out for alternative options to a formal insolvency proceeding.

II. Out-of-Court Restructurings

In light of tightened credit markets and depressed or uncertain asset values resulting from the global economic recession, lenders have been reluctant to crystallize losses through a formal insolvency sale or liquidation and seem content in many cases to delay the realization decision in hopes that the economy will rebound and boost returns and minimize their losses.

"Amend and extend" or "extend and pretend" arrangements — which reflect this "wait and see" or "kick the can down the road" approach — have become an increasingly popular mechanism to restructure a company's balance sheet out-of-court or through a *CBCA* arrangement. These amend-and-extend arrangements are generally considered to have contributed to pushing out the start of the so-called "maturity wall" — the trillion plus dollars of corporate debt that will need to be repaid in the next five years. Amend-and-extend arrangements can be relatively simple or more complex and can be implemented through a variety of structures, often with some kind of de-leveraging mechanism, either by way of a lump sum principal repayment, increased

amortization payments and/or a partial debt-to-equity conversion, by way of direct conversion or a convertible instrument.

The biggest challenge in implementing a restructuring out-of-court is trying to obtain a consensus among creditors and other affected parties without the discipline of a court-supervised process or the ability to cram down dissenting members within an affected creditor class. This process involves a delicate exercise of balancing very different and often conflicting stakeholder interests and has become more challenging given the complex capital structures and the diversity among providers of capital that exist today. The ability to successfully navigate a consensual out-of-court restructuring will largely be dictated by the dynamics between and within the relevant creditor constituencies. In situations where there are syndicated credit facilities or notes or bonds, the conflicts among lenders or holders in that group ("intra-creditor conflicts") can be more difficult to manage than the conflicts between different creditor groups. If creditors are located in multiple jurisdictions, differences in the applicable legal and tax regimes may offer differing incentives for cooperation which may further complicate those dynamics.

For these reasons, an out-of-court restructuring is not always quicker to implement than a formal insolvency proceeding that has the benefit of court supervision to corral consensus. It is also debatable whether an out-of-court restructuring is cheaper than an abridged formal insolvency process (*i.e.*, a pre-packaged filing) or even a *CBCA* arrangement in terms of legal costs to implement the restructuring. Out-of-court restructurings are most effective where there are only a small number of stakeholders that need to be affected. It is also very difficult to effect an operational restructuring out-of-court because of the difficulty of trying to settle the number and types of claims that would need to be settled in these circumstances.

Given the complex financial and legal issues and creditor dynamics, successfully implementing a restructuring out-of-court can be a challenging undertaking. Support or lock-up agreements — pursuant to which affected stakeholder support for a restructuring is lined up prior to the commencement of the restructuring — are very commonly used tools, whether out-of-court, in connection with a *CBCA* arrangement or in connection with a filing under the *CCAA* or *Chapter 11*. They have also become an essential tool to bring discipline to an out-of-court restructuring, to incentivize cooperation and to raise the cost to those who wish to dissent from the consensual process.

Typically, but not always, the support or lock-up agreement in an out-of-court restructuring will seek to commit the parties to the implementation of the proposed restructuring through a formal process (a *CBCA* arrangement and/or *CCAA* process), if an out-of-court solution cannot be achieved on the terms and timelines established in the support or lock-up agreement. This technique serves to motivate affected parties who have not yet consented to cooperate because it telegraphs to dissenting creditors that the proposed restructuring can and will be implemented even if a consensus cannot be reached. In a negotiation with holdouts, the leverage of these dissenting parties can be undercut if there are sufficient consenting parties committed to supporting the proposed restructuring through a formal mechanism (*i.e.*, the minimum creditor approval threshold) even if the consensus required for a consensual process is not obtainable within a specified timeline. That proposed restructuring can then be imposed on the dissenting parties. However, dissenting parties are also aware that there may be additional cost to implementing the restructuring through a formal proceeding, particularly if the formal proceeding is a *CCAA* or *Chapter 11* process, both in terms of legal and administrative costs but also impact

on the debtor's business and erosion of value. As such, the threat of imposing a restructuring through a formal process sometimes may not be viewed by dissenting parties as a credible threat.

A recent technique that has become quite common in support and lock-up agreements to motivate dissenting creditors to cooperate is the use of a consent as a "carrot". The consent fee provides additional consideration to be shared among parties who consent to the terms of the support or lock-up agreement prior to a determined date. A consent fee provides an additional incentive for cooperation and provides a dissenting lender with a real and tangible cost if it chooses to continue its opposition to the proposed restructuring. The consent fee is typically offered up to all creditors whose consent is being requested so that it does not offend the principle of equal treatment of members of the same class. Various consent fee structures have been utilized in a number of recent *CBCA* cases.

Where unanimous participation is not required by the proposed restructuring, exchange offers can be used in situations involving public-company-issued debt to reduce outstanding debt and/or to extend the maturity of outstanding debt obligations, subject to compliance with applicable securities law requirements and subject to restrictions contained in existing debt documents. In an exchange offer, a company makes an offer to holders of certain outstanding securities to exchange the existing debt securities for new debt securities or equity securities or for a combination of debt and equity securities. Holdouts who choose not to participate in the exchange offer will continue to hold existing notes on the same existing economic terms. However, they may lose some or all of their covenant protections if these are stripped from the debt securities because the company also obtains, in conjunction with the exchange offer, the required level of consents under the applicable trust indentures to effect such amendments. The result is that holdouts will be left with the existing notes on the same existing economic terms but will lose any right to accelerate the debt prior to the original maturity date. Debt exchange offers may also be conditional on a minimum tender percentage, which is usually quite high, to ensure that only a limited number of holdouts or freeriders are able to obtain the benefits of the restructured balance sheet which results from the implementation of the exchange offer.

An exchange offer formed part of the recent restructuring of *Angiotech Pharmaceuticals, Inc.* Initially, the restructuring was to be effected out-of-court by way of two exchange offers. An exchange offer was made to one set of noteholders for new amended notes, which notes would allow another set of noteholders to implement a debt for equity exchange through a different exchange offer. That structure was ultimately amended so that the debt-to-equity exchange is to be implemented through a *CCAA* plan of compromise or arrangement while the restructuring of the other set of notes was effected through an exchange offer outside of the *CCAA* plan process.

III. The CBCA Arrangement Restructuring Option

(i) Introduction

The *CBCA* arrangement provision is found in s. 192(3) of the *CBCA* which provides that, where it is not practicable for a corporation "that is not insolvent" to effect a fundamental change in the nature of an "arrangement" under the *CBCA*, the corporation may apply to a court for an order approving the arrangement proposed by the corporation. An "arrangement" includes a transfer of all or substantially all of the property of a corporation to another body corporate in exchange for property, money or securities of the body corporate, or an exchange of securities of a corporation for property, money or other securities of the corporation or property, money or securities of another

body corporate. The arrangement provisions are commonly used in non-distressed situations to effect mergers and other non-distressed corporate reorganizations. However, in the past few years, the *CBCA* arrangement mechanism, in particular, the ability to exchange securities of one type for another, has been used to successfully eliminate hundreds of millions of dollars of debt securities from the balance sheets of several Canadian companies, including *Tembec Inc.* (2008)*, Ainsworth Lumber Co. Ltd*. (2008)*, Gateway Casinos (2010), MEGABrands Inc.* (2010), *Frontera Copper Corporation* (2010) and *Compton Petroleum Corporation* (2010), making *CBCA* arrangements very much a part of the matrix of restructuring options available in Canada and an important development for holders of Canadian debt securities.

(ii) The *CBCA* Process — Procedural and Statutory Requirements

The appeal of the *CBCA* arrangement mechanism is that it can be a simpler and quicker alternative than a formal filing under the *CCAA*. The *CBCA* arrangement mechanism permits a focused surgical strike on a company's balance sheet while trade debt and other unsecured creditors remain unaffected by the process. The *CBCA* arrangement process can take as little as 30 days from the date of the interim order, which is largely procedural in nature, to the final order, which sanctions the proposed plan of arrangement as fair and reasonable.

A significant component of the appeal of a *CBCA* arrangement is that it does not appear to carry with it the same degree of bankruptcy stigma that is associated with a formal insolvency filing. On a formal insolvency filing, the applicant is required to make a very public declaration of its insolvency. In contrast, the *CBCA* arrangement process is effected under a non-insolvency corporate statute that applies, on its face, only to solvent entities.

The availability of the *CBCA* arrangement mechanism may increase the leverage of the distressed company and consenting creditors in a proposed out-of-court arrangement. The threat of a *CBCA* arrangement process that can bind dissenting lenders where the required consensus (unanimity or otherwise) cannot be achieved out-of-court may incentivise cooperation. For the reasons discussed in this article, the *CBCA* arrangement process may be a more palatable alternative than a *CCAA* filing for the debtor company and its stakeholders, and the *CBCA* arrangement approval threshold may be easier to obtain than the approval of a plan under the *CCAA*. The threat to commence proceedings under the *CBCA* may therefore be seen as more credible by dissenting creditors who are seeking to leverage their dissent in an out-of-court restructuring.

Throughout the *CBCA* arrangement process, management remains in full control, unlike the *CCAA* process in which the company remains in possession and control of its assets and business but is subject to the oversight (and costs) of a monitor appointed by the court to supervise the affairs of the company. From a management point of view, this can be a significant factor in favour of a *CBCA* process over a *CCAA* process.

Similar to the *CCAA* process, a *CBCA* plan of arrangement seeking to compromise debt is subject to affected creditor and court approval. However, unlike the *CCAA* process which expressly sets out a requirement that creditors approve the proposed restructuring plan by a double majority (two-thirds in value and a majority in number), the *CBCA* arrangement process does not mandate any express statutory threshold for creditor approval. Recent cases have established a precedent of two-thirds in value as being an acceptable threshold, but it remains to be seen whether a court would accept a lower approval threshold. Even so, Canadian courts to date have not required a majority in

number of creditors to approve a *CBCA* arrangement. Therefore, in terms of the level of support required from affected creditors, the creditor approval threshold can be easier to obtain under the *CBCA* arrangement process than under the *CCAA* plan process.

In a *CBCA* arrangement process, existing equity is more likely able to preserve some value, even if in significantly diluted form, rather than being at risk of being wiped out entirely in an insolvency proceeding. As with creditor approval, there is no express statutory requirement for a shareholder vote in the *CBCA* arrangement process. However, a shareholder vote has been held in certain cases, where the existing shares were being cancelled (including *Tembec* and *Ainsworth*), and where the equity was not being cancelled but significantly diluted (including *MEGABrands Inc.*). Applicable securities legislation and regulatory requirements may require shareholder approval depending on the level of dilution, or the Director of the *CBCA* (*CBCA* Director) may require it where "a proposed arrangement fundamentally alters the security-holders investment, whether economically or otherwise". To the extent required, that shareholder approval may be obtained prior to the commencement of the *CBCA* process.

Subsection 192(5) of the *CBCA* requires the applicant to give notice to the *CBCA* Director of an application under the *CBCA*, and entitles the *CBCA* Director to appear and be heard in person or by counsel. Notice is required to be given on an application for both an interim order (under which the *CBCA* plan of arrangement proceedings is initiated) and a final order (under which the *CBCA* plan of arrangement approved by securityholders including, if applicable, shareholders, is approved by the court as "fair and reasonable").

The *CBCA* Director has indicated in its *CBCA* policy statement[1] that it regards a minimum of five working days prior notice to the date of the hearing seeking an interim order to be the minimum sufficient notice period, and requests that the notice should be accompanied by materials sufficient to allow the *CBCA* Director to make a proper determination of compliance with the *CBCA* statutory requirements (including an affidavit supporting the filing, notices to affected securityholders, draft management proxy circular and proxies, draft *CBCA* plan of arrangement, draft interim order and the most recent financial statements of the applicant corporation). Interim orders are typically obtained on an *ex parte* basis, although practically a creditor group that has been negotiating with an applicant may attend on an informal basis. With respect to a final order, the *CBCA* Director has advised that it requires a minimum of three working days prior notice to the date of the final hearing, accompanied by materials demonstrating securityholder quorum and approval, the issued interim order and a draft final order. Any departures from the timelines recommended by the *CBCA* Director must be justified by the *CBCA* applicant.

(iii) Statutory Requirements

For the *CBCA* arrangement process to be available to a debtor, there are certain conditions that must first be satisfied.

(a) The Solvency Requirement

As mentioned above, the *CBCA* arrangement provision provides that it applies to a corporation "that is not insolvent". However, notwithstanding this, the *CBCA* arrangement process has been utilized to restructure insolvent companies with increasing frequency and in doing so, Canadian courts have primarily relied on two grounds to permit this.

First, Canadian courts have found that the solvency requirement has been met in cases in which one of the principal corporate entities involved in the overall arrangement transaction is solvent, even if the arrangement involves obligations of an operating business that is insolvent. In

this manner, the obligations of the insolvent operating company can be restructured via an arrangement by establishing a newly formed solvent company to take part in the arrangement even though the principal company is insolvent. In an arrangement which involves an exchange of securities, the obligations of the insolvent company evidenced by debt securities may be exchanged for new debt securities issued by a solvent newly established company. Examples of this approach include the arrangements obtained by *Tembec Inc., Gateway Casinos* and the aborted *CBCA* arrangement process with respect to *Abitibi-Consolidated Inc.* and certain related parties.

Second, Canadian courts have considered whether the applicant, although insolvent at the interim hearing date, will be solvent at the date of the final order, after implementation of the arrangement. Through this interpretation, a corporation may be insolvent in light of a looming maturity date under its debt securities, but made solvent by use of a *CBCA* plan of arrangement to convert debt held by securityholders into equity (as in the arrangement obtained in *Ainsworth* and *Gateway Casinos*) or to "amend and extend" the debt securities by altering the terms of payment and/or pushing back the maturity date through an exchange of existing debt securities notes for new debt securities with modified terms. Examples of this approach include the arrangements obtained in *Frontera Copper Corporation* and *Compton Petroleum Corporation*.

The solvency limitations under the *CBCA* have been addressed by the *CBCA* Director and the two approaches discussed above have been endorsed. Nevertheless, the *CBCA* Director has advised that, where it is not apparent from the affidavit materials provided to the *CBCA* Director with notice of the interim hearing that the solvency limitation has been complied with, the *CBCA* Director may request additional financial information demonstrating compliance or, in certain cases, intervene to oppose the interim order on the basis of non-compliance with the solvency limitation.

(b) The Jurisdiction Requirement

The *CBCA* is a federal corporate statute governing federally incorporated companies. The applicable provision relating to arrangements provides that applicants under the *CBCA* arrangement process must be a company incorporated under the *CBCA*. While it may be possible to implement a debt restructuring under the applicable provincial corporate statute for provincially incorporated companies, the arrangement provisions in the provincial statutes are not identical to the *CBCA* arrangement provisions and must be carefully reviewed as they may be more onerous. For example, many provincial corporate statutes (such as the British Columbia's *Business Corporations Act*, SBC 2002, CHAPTER 57) will contain express statutory thresholds for approval, which can be higher than the commonly accepted two-thirds threshold under the *CBCA*. As well, the broad authority given to the courts in the *CBCA* to make any interim or final order "it thinks fit" is not contained in all provincial corporations statutes (see, for example, Alberta's *Business Corporations Act*, SA 2000, c. B-9)[2] and therefore the court's authority to grant stays of proceedings under those statutes may be more limited than that available under the *CBCA* arrangement provisions.

For provincially incorporated companies, where the provincial corporations' statute contains more onerous or less favourable terms, the *CBCA* requirement may be addressed by continuing one or more of the applicant companies under the *CBCA* through the corporate continuance process available under the corporate statutes. This occurred in the *Ainsworth Lumber Co. Ltd.*, *Gateway Casinos* and *MEGABrands Inc. CBCA* arrangements. However, the continuance process itself may provide obstacles, as it may require shareholder approval under the

applicable statutes governing provincial business corporations.

(c) Exchange of Debt Securities

As mentioned above, the applicable section of the *CBCA* provides for an arrangement to include an exchange of securities of a corporation for property, money or other securities of the corporation or property, money or securities of another body corporate. As such, if the obligations sought to be restructured by a distressed company do not constitute "securities" under the *CBCA*, a *CBCA* arrangement will not be an available option to restructure the distressed company's debt and recourse will have to be had to other restructuring options.

The *CBCA* defines "security" to mean "a share of any class or series of shares or a debt obligation of a corporation and includes a certificate evidencing such a share or debt obligation" [underlined emphasis added]. The *CBCA* defines "debt obligation" to mean a "bond, debenture, note or other evidence of indebtedness or guarantee of a corporation, whether secured or not." The obligations sought to be compromised in the *CBCA* plans of arrangements made by *Ainsworth* and *Tembec* were evidenced by bonds and debentures that clearly fell within the *CBCA* definition of "securities".

While notes, bonds and debenture debt were expressly included in the definition of debt obligations, obligations under a credit agreement which are not evidenced by notes, bonds or debentures are not. Whether a credit agreement is sufficient "other evidence of indebtedness" was the subject of debate in the *CBCA* filing by the Abitibi group of companies in 2009. In *Abitibi*, there were no promissory notes evidencing the bank debt and the court had to be persuaded that the credit agreement was sufficient "other evidence of indebtedness" to constitute "securities" under the *CBCA*. The court was persuaded and found that the credit agreement was sufficient evidence of indebtedness. The lenders under the credit agreement challenged this finding, along with other aspects of the court's decision, but that appeal was rendered moot by Abitibi's subsequent filing under the *CCAA* for reasons unrelated to this issue. This decision in *Abitibi* became the subject of much debate.

The uncertainty brought on by the proposed *Abitibi CBCA* plan of arrangement and the subsequent appeal appears to have been largely muted by the arrangements of debt subsequent to *Abitibi* in connection with the *CBCA* plans of arrangements involving *MEGABrands Inc.* and *Gateway Casinos*, where *CBCA* plans of arrangement were approved to arrange, among, other things, debt obligations evidenced by a credit agreement. However, it should be noted that the lenders whose debt obligations were arranged by the arrangements in *MEGABrands Inc.* and *Gateway Casinos* did not object to such treatment and so the issue may not have yet been completely put to rest. If the issue does arise again in the future, one possible solution may be for the debtor company to issue a note evidencing the debt under a credit agreement, similar to what used to be done when instant trust deeds were issued prior to a *CCAA* filing to satisfy the then technical trust deed requirement. It was because of the court's acceptance of that practice that the trust deed eligibility requirement was eliminated from the *CCAA* as part of the 1997 set of amendments.

(iv) Limitations of the CBCA Arrangement Process

While recent cases have shown that the *CBCA* arrangement mechanism can be a quick and effective alternative to implementing a balance sheet restructuring under a formal insolvency process in certain cases, the *CBCA* arrangement process is not appropriate in all cases because of a number of limitations inherent in the process. Therefore, depending on the type of restructur-

ing that is required, or sought by the company and its relevant stakeholders, the *CBCA* arrangement process may not be the most appropriate restructuring option or may not even be available as an option.

As discussed in more detail below, some of the principal limitations are as follows. First, the *CBCA* arrangement process cannot be used to restructure trade debt or other claims other than claims considered to be "debt securities" as defined in the *CBCA*. Second, there is no mechanism within the *CBCA* arrangement process for a distressed company to disclaim underperforming contracts or downsize a workforce and have those claims arising as a result of such disclaimer or downsizing be the subject to compromise under a *CBCA* plan of arrangement. These limitations mean that a *CBCA* arrangement cannot effectively be used for any operational restructuring. Third, while there is at least one precedent to use the *CBCA* arrangement process for the marketing and sale of assets of a *CBCA* applicant,[3] it is not clear the extent that the *CBCA* process can be used to sell unwanted assets or lines of business pursuant to a vesting order as is frequently done in *CCAA* proceedings. In addition, the *CCAA* has been recently amended to set out specific criteria and protections that a court must consider when considering whether to approve proposed asset sales by the debtor company and no similar protections exist under the *CBCA*. Fourth, the scope of the stay of proceedings may be narrower than commonly obtained in a formal insolvency proceeding, so a *CBCA* arrangement process may not be a viable option if the distressed company needs to control the exercise of rights or remedies by certain creditors or other parties. Fifth, debtor-in-possession or other interim financing may not be available to the distressed company to fund working capital needs during the *CBCA* arrangement process. Lastly, a *CBCA* arrangement may not be as flexible as a formal insolvency proceeding in implementing a multi-jurisdictional restructuring.

(a) Debt Securities Limitations

As discussed above, the *CBCA* arrangement provision provides that the arrangement must be "an exchange of securities of a corporation for property, money or other securities of the corporation or property, money or securities of another body corporate". While there has been some debate about whether bank debt evidenced by a credit agreement constitutes "securities", it is generally accepted that the *CBCA* arrangement process cannot be used to restructure trade debt and other general unsecured liabilities, including contingent liabilities, which are often subject to compromises under the *CCAA* and *Chapter 11*. In its policy statement, the *CBCA* Director took the unequivocal view that liabilities of ordinary unsecured creditors, such as trade creditors, were not claims of "securityholders" and therefore were not covered by the *CBCA* and could not be compromised by a *CBCA* plan of arrangement. The *CBCA* Director also expressed its concern about the use of the *CBCA* arrangement procedure to adversely affect or to compromise contingent claims. As such, pension liabilities and litigation claims and other contingent liabilities are also not likely subject to the *CBCA* arrangement provisions. Under the *CBCA* arrangement process, the *CBCA* Director has a statutory right to make submissions of any proposed arrangement under the *CBCA*. Given its policy statement discussed above, it would appear likely that the *CBCA* Director would challenge any *CBCA* plan of arrangement which sought to compromise debt obligations which did not, in the view of the *CBCA* Director, constitute "securities" under the *CBCA*.

It appears that the *CBCA* arrangement provisions are broad enough to force securityholders to accept securities in a non-*CBCA* entity in a plan of arrangement exchange since the relevant provision permits securityholder to obtain securities of "another body corporate". "Body corporate" is defined in the *CBCA* to include "a

company of other body corporate wherever or however incorporated". This provides a measure of flexibility in crafting an arrangement, particularly a debt-to-equity exchange.

(b) Operational Restructuring Limitations

There is limited utility in pursuing a *CBCA* arrangement in distressed situations where the most viable solution will require an operational restructuring. Unlike the *CCAA*, there are no provisions under the *CBCA* which allow a debtor company to disclaim burdensome contracts or terminate leases, assign contracts without counterparty consent or provide for payment of critical suppliers. Even if a court was prepared to grant relief of this nature to a distressed company in an arrangement, on the basis of its discretion under its powers to grant any order "it deems fit", there would be no advantage to the debtor company as the claims arising from the disclaimer of contracts, for example, are not likely capable of being compromised in a *CBCA* plan of arrangement. Likewise, a *CBCA* process offers no utility if workforce reductions are sought or legacy obligations are causing or contributing to the debtor company's financial distress. Although the court does have the discretion in the *CBCA* arrangement provisions to make any interim or final order "it thinks fit", the court is still limited by the fact that these claims arising from a disclaimer of contracts or downsizing of workforce are not "securities" as defined in the *CBCA*.

With respect to assignments of agreements, prior to the recent round of bankruptcy amendments there had been significant controversy over whether the court could order an assignment of an agreement despite restrictions against assignment in the agreement and over the objections of the counterparty pursuant to the court's inherent jurisdiction or judicial discretion. It would therefore be difficult to see how the court could derive the judicial discretion to order such an assignment under a non-insolvency statute, unless such statute contained an express right to do so.

(c) Availability of Interim Financing

If debtor-in-possession ("DIP") financing is required by the debtor company during the period that it is undergoing the *CBCA* process, there is no real framework for the court to order priming security. It is true that prior to the September 2009 amendments to the *CCAA*, there were no express provisions authorizing DIP financing under the *CCAA*. Instead, the courts relied on their judicial discretion under *CCAA* to grant DIP financing and to impose super-priority charges over the debtor company's assets to secure the DIP financing. However, although it may be technically possible for the court to approve a DIP super-priority charge relying on the broad discretion of the court given under the *CBCA* to make any interim or final order "it thinks fit", the court would likely vigorously scrutinize any attempt to substantively alter secured creditors rights without notice to such parties and without such parties' consent. This scrutiny may be heightened by the fact that the amendments to the *CCAA* have provided substantive protections in favour of existing secured creditors where DIP charges are sought that are not duplicated under the *CBCA*. This contributes to the growing risk that, as a *CBCA* process begins to more closely resemble a *CCAA* restructuring, courts may begin to seek to balance the prejudice to the debtor company and its stakeholders which may erode some of the advantages that the *CBCA* arrangement process now has over the *CCAA* process.

(d) Jurisdictional Limitations

The requirement that the applicant must be a *CBCA* corporation has been detailed above. Given the complex corporate structures adopted by most businesses operating in multiple jurisdictions, and the reality that the vast majority of corporate debt has been guaranteed and secured against the assets

of multiple members of a corporate group, in many cases the arrangement of debt securities of a *CBCA* company will affect non-*CBCA* companies within the corporate group.

For non-*CBCA* Canadian companies, as discussed above, the continuance mechanism may be available in certain circumstances. However, this mechanism may not be available in many circumstances for tax, regulatory or other reasons. With respect to non-Canadian companies, there is precedent for non-*CBCA* companies, including U.S. companies, to be included in a *CBCA* plan of arrangement as interested parties in certain circumstances.

In *MEGABrand*s *Inc.*, U.S. affiliates of the principal applicant *CBCA* company who had guaranteed the principal applicant's debt were included in the plan of arrangement. In order to make the plan of arrangement binding on securityholders outside of Canada, recognition of the plan of arrangement was sought and obtained under Chapter 15 of the *U.S. Bankruptcy Code* [*Chapter 15*]. Chapter 15 allows a U.S. bankruptcy court to recognize the relief granted in a foreign proceeding in regard to "insolvency or adjustment of debt in which proceeding the assets and affairs of the debtors are subject to control or supervision by a foreign court, for the purpose of reorganization". As seen from *MEGABrands Inc.*, the reference to "insolvency or adjustment of debt" does not limit the application of *Chapter 15* to restructurings under the *CCAA* or the other principal Canadian insolvency statutes but can extend to debt arrangements under the *CBCA* since such an arrangement is clearly an adjustment of debt for the purposes of reorganization of the affairs of a *CBCA* company.

In *MEGABrands Inc.*, the *CBCA* process was also used to restructure the bank obligations owing by a U.S. limited partnership. In that case, the general partner was a *CBCA* corporation (who was an applicant under the *CBCA* process) and the applicable corporate law provided that the general partner would be directly liable for obligations of the limited partnership under the credit agreement.

(e) Scope of Stay of Proceedings

The current Ontario model *CBCA* interim order does not contain a stay of proceedings. Some recent *CBCA* interim orders have not provided for any stays. However, in some *CBCA* cases the courts have granted a stay of proceedings during the brief period during the *CBCA* proceedings. The authority to grant the stay of proceedings has arisen from the discretion of the court to make orders that "it thinks fit". Where stays of proceedings are granted in *CBCA* arrangement proceedings, they are typically less prejudicial to creditors than stays obtained under the *CCAA* because of the rapid timeline typical to a *CBCA* arrangement and because of their comparatively narrower scope. For example, several *CBCA* interim orders have limited the stays to exercises of rights and remedies as a result of the debtor company having made an application to the court pursuant to the *CBCA* or as a result of a transaction or arrangement relating to the *CBCA* proceeding or proposed plan of arrangement. The narrower scope of the stay may leave the applicant company exposed to the exercise of rights or remedies of third parties that would ordinarily be stayed in a formal insolvency proceeding.

As debtor companies and their counsel succumb to the temptation to seek more comprehensive stays in line with those typically obtained in *CCAA* proceedings, there is a real risk that courts may begin to question the appropriateness of commencing a *CBCA* proceeding if the type of relief sought is more readily obtainable under the *CCAA*. In the aborted *CBCA* arrangement of *Abitibi*, the interim order granted a broad stay of proceedings which was comparable in scope to a typical stay obtained under the

CCAA. This stay was one of the matters appealed by the term lenders (but as mentioned above, rendered moot by the subsequent *CCAA* filing). This response may be instructive of the response some stakeholders may have in respect of attempts to expand stay of proceedings in *CBCA* restructurings. In adjudicating the issue, courts may not be persuaded that the beneficial cost savings and lack of stigma to the applicant company using a *CBCA* process outweigh the substantive protections provided to stakeholders under the formal insolvency statutes.

(*f*) *Flexibility*

Courts have observed many times that the *CCAA* is remedial legislation, entitled to a large and liberal interpretation, and the exercise of judicial discretion to support the rehabilitation of financially distressed companies has been a hallmark of formal insolvency proceedings under the *CCAA*. While there remains an element of judicial discretion under the *CBCA* — particularly the statutory authority of the court to make any interim or final order "it thinks fit" — the *CBCA* is not remedial legislation and is not aimed to address the broad public policy goals animating the *CCAA*. As corporate legislation adapted to achieve a particular form of financial rehabilitation, the *CBCA* process may not be as flexible in assisting financially distressed companies in developing compromises and arrangements with their creditors as the insolvency statutes specifically designed for this purpose.

IV. Conclusion

Market conditions will continue to cause distressed and over-leveraged companies, their stakeholders and their respective advisors to look to alternative solutions to restructure their balance sheets. Accordingly, these parties will be motivated to continue to develop innovative structures, techniques and mechanisms as alternatives to a formal insolvency proceeding. Out-of-court restructurings are hampered by complex capital structures and the resulting difficulties in trying to achieve the required or desired consensus. A *CBCA* arrangement under the right circumstances can prove to be a useful option to affect restructurings of debt securities while avoiding the cost, delay and stigma of a formal insolvency proceeding. However, limitations inherent in the *CBCA* arrangement process may continue to limit the use of *CBCA* arrangements as complete alternatives to formal insolvency proceedings in a number of situations. Moreover, as *CBCA* arrangements continue to adopt features found in restructurings under the *CCAA*, courts may begin to question whether it is appropriate to grant the types of relief typically sought by debtors in *CCAA* proceedings within a *CBCA* process without any protections for creditors and other stakeholders in those proceedings as otherwise found in *CCAA* proceedings.

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[1] Industry Canada, Policy Statement 15.1, "Policy Concerning Arrangements under Section 192 of the CBCA" (January 4, 2010).

[2] Bourassa, Kelly, "Stay Under the Business Corporations Act (Alberta)" Blakes Bulletin on Restructuring & Insolvency (November 16, 2010), online: Blake, Cassels & Graydon LLP <http://www.blakes.com/english/view_bulletin.asp?ID=4343>.

[3] See *Look Communications Inc.* (2009).

• COLLECTING FOREIGN CURRENCY DEBTS IN BRITISH COLUMBIA: AN EXAMINATION OF THE *FOREIGN MONEY CLAIMS ACT* •

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In the last three years, the Canadian dollar has seen a great deal of volatility — in the Spring of 2008, the Canadian dollar was on par with the U.S. dollar, and competitive against other major currencies such as the British Pound and the Euro. Six months later, as the global financial system began to show serious signs of weakness, the value of the Canadian dollar quickly slid to 77 cents U.S. Today, the Canadian dollar hovers within five cents of the U.S. dollar.

For foreign creditors of Canadian companies or individuals, currency volatility is an obvious problem. Some foreign companies doing business in Canada go to great lengths to address this problem — implementing hedge structures or other sophisticated financial instruments to minimize foreign exchange losses. But in the context of litigation, where a plaintiff creditor may have to compromise its claim in order to recover money from the debtor, currency fluctuation is not always seen as a significant issue: most of the time, creditors are content to convert the amount owing in the foreign currency to Canadian dollars, and simply proceed with the litigation using the Canadian dollar amount. In most cases, the effect of currency volatility on the amount owing is seen as something that is a minor issue compared to the question of how much the creditor can expect to recover from the debtor at the end of the day. In other words, currency volatility is just part of the "cost of litigation" in a foreign country.

A Case Study

In some situations, however, the change in the value of Canadian currency can seriously prejudice a foreign creditor. In those cases, careful decision making on the part of the creditor's counsel can minimize or even eliminate the adverse effect of currency fluctuations. Consider the following example:

> Company A, a U.S. company, sells a certain quantity of goods to Company B, a British Columbia corporation with offices in Vancouver, B.C. The price of the goods, $1,000,000, is stated in U.S. dollars. The sale takes place on January 25, 2008 and the goods are delivered to Company B on the same day, along with an invoice requiring payment within 30 days. Incidentally, on January 25, 2008, the Canadian dollar was equivalent in value to the U.S. dollar in the currency market.
>
> For whatever reason, Company B fails to pay the invoice. Some four months later, after numerous requests by Company A, Company B has still not paid the outstanding invoice, and shows no signs of doing so. In May 2008, Company A retains counsel in Vancouver to pursue its claim against Company B. A Claim is filed and served and, for whatever reason, Company B fails to respond to the Claim. Company A obtains a default judgment against Company B on May 21, 2008.

What is the value of Company A's judgment? Counsel has likely stated in the Claim that the amount owing is in U.S. dollars. In Ontario, the creditor could obtain a judgment stated in the foreign currency, and then rely on s. 121 of the *Courts of Justice Act,* R.S.O. 1990, c. C.43, to convert any amounts paid in Canadian dollars to U.S. currency.

In British Columbia, however, judgments must be stated in Canadian currency — the Court cannot issue a judgment requiring the repayment of an amount of foreign currency. Consequently, creditors in British Columbia with debts stated in foreign currency must use the *Foreign Money*

Claims Act, RSBC 1996, CHAPTER 155 [*FMCA*], if they wish to have their debt measured in a foreign currency. Unlike s. 121 of the Ontario *Courts of Justice Act*, the *FMCA* does not apply automatically to judgments measured in foreign currency — the creditor must obtain an order under the *FMCA* that specifically applies to the judgment amount.

To return to the example presented above, on May 21, 2008, the Canadian dollar was actually worth more than the U.S. dollar in the currency market — the Bank of Canada's posted exchange rate was 1.02. As a result, the value of Company A's judgment in Canadian dollars, on May 21, 2008 was CDN$984,400. If counsel was not aware of the *FMCA* or chose not to use it, judgment would be issued in favour of Company A for CDN$984,400. With the benefit of hindsight, one can easily see why this is not a favourable result for Company A.

To continue the example, assume that Company A receives a payment of $984,000 from the debtor on October 28, 2008. This payment fully satisfies the terms of the B.C. judgment (if the issue of costs is ignored). However, when Company A converts the payment into U.S. Dollars, Company A finds that the Canadian dollar is trading at only 77 cents U.S. — the lowest rate since August 30, 2004. As a result, Company A's recovery on its $1 million debt is only $758,000.

Despite the fact that Company A obtained default judgment and then received a voluntary payment for the full amount of the judgment within six months of starting the Claim, Company A has only recovered 75 per cent of the outstanding debt, and has no recourse to recover the balance.

Using the FMCA

What could Company A do to obtain a better result? If counsel had referred to the *FMCA* in the Statement of Claim, and if there was evidence before the court that Company A would be "truly and exactly compensated" by measuring the amount owing in a foreign currency, then counsel could have obtained an order in the following form:

> *The plaintiff shall recover judgment from the defendant in the amount of Canadian currency necessary to purchase the equivalent amount of US$1,000,000 at a chartered bank located in British Columbia at the close of business on the conversion date as defined by s. 1(2) of the Foreign Money Claims Act, R.S.B.C. 1996, c. 155.*

An order in the form above would have the same effect as s. 121 of the Ontario *Courts of Justice Act* — Company A would be able to convert the payment into U.S. Dollars using the exchange rate at the end of the previous business day, and if its judgment was not fully satisfied, it could continue to pursue the debtor for the outstanding portion of the judgment.

In the example presented above, this would allow Company A to pursue the debtor for a further US$242,000 after the voluntary payment made on October 28, 2008. This represents almost 25 per cent of the outstanding debt.

Voluntary Payment v. Enforcement

At this point, one might think that it is always better to use the *FMCA* when dealing with a foreign currency debt. However, there is an important distinction in the *FMCA* between:
(a) voluntary payment of the judgment by the debtor; and (b) payments that are made following an enforcement proceeding (*i.e.*, the forced sale of a parcel of land to satisfy a judgment debt).

In the case of voluntary payments, the amount is converted using the prevailing exchange rate on the day prior to *payment*, as described above. But if the judgment creditor is required to commence enforcement proceedings in order to satisfy its judgment, the conversion date is **not** the day before payment is made, but rather the day before the enforcement proceeding is *commenced*.

Since enforcement proceedings can often take many months, this may significantly reduce the

value of using the *FMCA*, especially in situations where the currencies at issue are volatile. This may be less of an issue where there has been a change in the value of the currency and there is reason to believe that currency value will remain constant during the enforcement process.

To return to the example presented above, what Company A is able to recover will change significantly depending on whether it has to enforce the judgment, and when it chooses to commence enforcement proceedings.

Assume that Company A obtains a judgment using the *FMCA* language. It then chooses to enforce the judgment by forcing the sale of a piece of land owned by Company B, which has significant value.

If Company A commences enforcement proceedings on June 3, 2008, it would be entitled to CDN$1,000,000 *at the end of the enforcement proceeding — i.e.* after the property is sold — because the prevailing exchange rate on June 2, 2008 was 1.00. The *FMCA* does *not* account for changes in the exchange rate between the time that enforcement proceedings are commenced, and the time that enforcement proceedings are completed. In reality, enforcement proceedings can be very slow, taking several months or even several years from beginning to end.

If enforcement proceedings were commenced on August 11, 2008, Company A would be entitled to receive CDN$1,063,829 after the property was sold, because the prevailing exchange rate on August 10, 2008 was 0.94. If Company A had waited until October 29, 2008, it would be entitled to CDN$1,290,000, because the prevailing exchange rate on October 28, 2008 was 0.77. But if Company A had waited until April 29, 2011 to start its enforcement proceedings, it would only be entitled to CDN$948,000, as the prevailing exchange rate on April 28, 2011 was 1.05 — the highest rate in several years.

Consequently, when acting as counsel to the creditor, one must take a variety of factors into account when advising a client on whether to seek an order that refers to the *FMCA*. In situations where the value of the foreign currency is falling in relation to the Canadian Dollar, one may decide not to use the *FMCA* and simply obtain a judgment in Canadian Dollars.[1] On the other hand, where it is clear that payment on the judgment will not occur immediately but may occur at some point in the distant future, an order that refers to the *FMCA* may insulate the creditor from future currency fluctuation.

The Debtor's Perspective

Are there any benefits to the debtor if a creditor obtains a judgment containing the *FMCA* language?

This was one of the issues before the Court in *Litecubes LLC v. Northern Light Products Inc.*,[2] though in that case, the Court found that both the plaintiff and the defendant had misunderstood the effect of the *FMCA* on the resulting judgment. The plaintiff was seeking to enforce a foreign (USD) judgment, and wanted the judgment converted to a Canadian dollar amount on the date that the judgment was recognized by the B.C. Court — February 17, 2009. The plaintiff argued that there were no special circumstances, and so there was no need to measure the debt in U.S. Dollars.

One need only look to the prevailing exchange rate on February 17, 2009 to understand why the *creditor* was seeking to fix the conversion date instead of seeking an order consistent with the *FMCA*. On February 17, 2009, the US/CDN exchange rate was 0.79, one of the lowest exchange rates posted by the Bank of Canada in the last three years. By converting the judgment to Canadian Dollars on that day, the plaintiff would be in a position to obtain a Canadian judgment that was potentially worth significantly more than the original U.S. judgment.

Recognizing this, the debtor argued that the conversion date should be the date that the judgment was originally pronounced by the foreign court — a date earlier than February 17, 2009, and presumably a date where the exchange rate was higher than 0.79.[3] The debtor was attempting to reduce the amount of money it would have to pay to the creditor, but it was doing so by attempting to fix the conversion date to a date that was favourable to the debtor.

Madam Justice Griffin rejected the plaintiff's argument, and found that an order consistent with the *FMCA* was appropriate in the circumstances. She found that the plaintiff would be "truly and exactly compensated" by measuring the debt in U.S. currency, and that in light of this finding, the plaintiff could not choose to convert the debt to a Canadian currency amount as of February 17, 2009. Instead, the payment would be converted in accordance with the *FMCA* — using either the rate on the day before payment (in the case of a voluntary payment), or the day before enforcement proceedings were commenced.

Although Madame Justice Griffin's order was not the order that the defendant in *Litecubes* had asked for, one might argue that an *FMCA* order actually favours the *Litecubes'* defendant. It prevents the plaintiff from obtaining a windfall resulting from a low exchange rate, and it lets the defendant take advantage of any increases in the exchange rate during the payment period.

In the end, a judgment debtor's options are limited, especially if the debtor has assets that might be sold to satisfy a judgment. If the debtor's assets are substantial, the debtor may choose to make a voluntary payment at a time when the exchange rate is high, as that may result in savings to the debtor. On the other hand, if the value of the judgment is large and the debtor has few assets, there may be no value to making a voluntary payment, as there may not be sufficient assets to satisfy the judgment, regardless of the currency it is measured in.

Conclusion

The British Columbia *Foreign Money Claims Act* may allow some creditors to achieve greater success with respect to the collection of a debt in British Columbia, especially in situations where the debtor's assets may be sufficient to satisfy the judgment. Since the *FMCA* will not apply to a judgment debt unless specifically pleaded and sought by the creditor, it is important for creditors to consider whether or not the circumstances before them militate in favour or against the usage of the *FMCA*. Counsel acting for a creditor seeking to recover a foreign currency debt should be mindful that failure to plead the *FMCA* and obtain a judgment that contains the *FMCA* language could reduce the creditor's ability to collect on its judgment and be "truly and exactly compensated."

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[1] The ability to do this may be limited by the Court. See the discussion below regarding the decision in *Litecubes.*

[2] [2009] B.C.J. No. 629, 2009 BCSC 427.

[3] Unfortunately, the exact dates sought by the defendant are not stated in the decision.