



Cross-Border Restructuring in the Energy Industry: An Overview of Canadian Insolvency Law

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LESLIE GARDNER: The Association of Corporate Counsel and SmartPros Legal and Ethics welcome you to today's webcast, "Cross-Border Restructuring in the Energy Industry: An Overview of Canadian Insolvency Law."

[The instructions provided here were intended for attendees of the live webcast when it was originally broadcast. You may submit questions and comments regarding the content of this course using the Questions and Comments link on the left side of your screen below the video.]

Our presentation today will be moderated by Nicole Spaur, senior counsel of Shell Oil Company. And now I'm going to turn it over to Nicole.

NICOLE SPAUR: Great, thank you, Leslie. Welcome everyone; I'm glad you could join us today. As Leslie mentioned, my name is Nicole Spaur, and I'm the chair of the ACC Energy Committee. And we have been very fortunate this year to have two wonderful law firm sponsors: Covington and Burling from the U.S., and Fraser Milner Casgrain, a Canadian law firm. Both of these law firms have provided excellent resources and programs for our members, and today we're especially grateful to Fraser Milner for sponsoring this webcast, and in particular, two of its partners who will be presenting today.

Today's webcast is entitled "Cross-Border Restructuring in the Energy Industry: An Overview of Canadian Insolvency Law." In light of restructuring topics becoming increasingly relevant to the global energy community, we have had several members request a webcast on this topic. So I'm pleased we're able to present on it today.

Our panelists will provide an overview of common Canadian insolvency processes, highlighting similarities and differences to U.S. processes. They will also address the current and proposed legislative changes to the Canadian insolvency regime, and their potential impacts to U.S. creditors and debtors. There's also a handout that was associated with this webcast, so please be sure to take a moment to look at it, and you can download the PDF to your own computer if you like.

So without further ado, I want to introduce our two speakers. David Mann is a partner with Fraser Milner Casgrain and he has 20 years of experience in the insolvency area, having appeared regularly before Alberta's Bankruptcy Court and Court of Appeals, as well as having made submissions to the Ontario Court of Appeals and Supreme Court of Canada. David has represented debtors, lenders, receivers, trustees, creditors and counterparties and been involved in a variety of insolvency proceedings that I suspect are well-known to many of our energy committee members, including Enron and SemGroup.

David LeGeyt is also a partner with Fraser Milner Casgrain, and a member of its insolvency and workout group. He focuses on advising clients in relation to all aspects of insolvencies and reorganizations and related litigation. Both speakers have presented on several insolvency topics, and you can access more information about them on Fraser Milner Casgrain's Web site, and you can also obtain some publications authored by each of them. We are very pleased to have them presenting today. And so, just before I turn it over to them, Leslie, can you please provide the first verification code for CLE credit.

LESLIE GARDNER: Thanks so much, Nicole.

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NICOLE SPAUR: Wonderful. Thanks, Leslie.

OK, with that I'm going to turn it over to David Mann.

DAVID MANN: Good afternoon and welcome to "Cross-Border Restructuring in the Energy Industry: An Overview of Canadian Insolvency Law." As you've heard, I'm David Mann, and in a moment you'll hear from my partner, David LeGeyt. We're partners of the law firm of Fraser Milner Casgrain, and we're located in the Calgary, Alberta office.

Before we begin with our formal program, I'd like to provide a quick background about our firm, Fraser Milner Casgrain. It's a leading Canadian business law firm of over 500 lawyers. We have offices in all of the major financial centers in Canada—Vancouver, Edmonton, Calgary, Toronto, Montreal and Ottawa. The easy way to remember that if you're a hockey fan is that anywhere you find an NHL team in Canada you find an FMC office. We have one of the largest restructuring groups in Canada, with over 40 dedicated practitioners. We're led by two co-national leaders, Shayne Kukulowicz out of the Toronto office and myself here in Calgary, and then each city in turn has a city lead who is well-versed and known in that community for insolvency. In Vancouver that's John Sandrelli, in Edmonton that's Ray Rutman, in Toronto it's Alex MacFarlane, in Ottawa it's Phil Rimer, and in Montreal it's Roger Simard.

With that bit of background in mind, what we'd like to do today is provide you with an overview of the common insolvency processes that you will encounter in Canada and then touch on some of the topics that are of more specific interest to our American friends that are doing business in Canada.

So in that respect, I'd like to introduce the first poll question. Leslie, if you could launch that for me?

LESLIE GARDNER: All right. The first poll is: "Please describe the nature of your business in Canada," and it varies a little bit from what you see as the poll question. I'm going to launch the poll now. Simply click on the answer and then we'll get the survey results. Is it Canadian parent or Canadian subsidiary? Supplier to, purchaser from, or a counterparty with Canada? Canadian acquisitions? Canadian partner or joint venture? Or lending to or from Canada? The poll is open. [We'll] give it a couple more seconds. And I'm now closing the poll. And here are the results of the poll: Eighty percent of our audience is a Canadian parent or Canadian subsidiary, with 20 percent being a supplier to, purchaser from, or a counterparty with Canada.

Thanks so much. That's our first poll. David, I'll hand it back to you.

DAVID MANN: Thank you, Leslie.

Let's start with an overview of the Canadian insolvency processes. There are three commonly known processes known in Canada: bankruptcy, receivership, and debtor-in-possession [DIP] restructuring. I'd like to address them by their degree of intrusiveness into the debtor's affairs. And just by way of background, there are two different debtor-in-possession restructuring regimes in this country: the Companies Creditors Arrangement Act, known as the CCAA, or "Double-C Double-A," and the Bankruptcy and Insolvency Act, the BIA.

Let's start with bankruptcy. Bankruptcy is governed by the Bankruptcy and Insolvency Act, and the bankruptcy can be initiated in one of three ways: a voluntary bankruptcy, which is done by way of an assignment, where the debtor assigns all of his assets to a trustee in bankruptcy; an involuntary bankruptcy, where a creditor petitions the debtor into bankruptcy because that debtor has committed an act of bankruptcy within the preceding six months, and the petitioning creditor is owed in excess of \$1000. The third way that a debtor can find himself in a bankruptcy is if it makes a restructuring under the Bankruptcy and Insolvency Act, known as a proposal, and that proposal fails. Then there is a deemed bankruptcy that occurs.

The Bankruptcy and Insolvency Act is a codification. It contains over 250 sections that prescribe the various rules and regulations governing how liquidations work. The assets vest—all of the debtor's assets vest in the trustee, subject to some certain exemptions; for example, trust property being held by the bankrupt on behalf of someone else; in the case of individual bankruptcy, exemptions that are afforded to them to allow them to carry on a living. Or secured creditor assets do

not vest in the trustee's estate, either. The trustee mandate can be easily and generally stated. They gather in the assets, they then liquidate those assets, and then distribute the proceeds of that liquidation to the creditors as they are entitled at law. As well, the Bankruptcy and Insolvency Act provides an enhanced recovery and investigative powers afforded to the trustee to assist in the recovery of assets.

A receivership—on our spectrum of most to least intrusive method into a debtor's estate—is next on the continuum. Receivers take possession and control of the assets and are generally used by a secured creditor to enforce its security to gather in its collateral and to liquidate that collateral and distribute it, again according to law, although generally speaking in such circumstances, the secured creditor is the primary beneficiary of those proceeds.

There are two different types of receivership: court versus private appointments. And the typical method for receivership is by court appointment, and the powers and the mandate of the receiver are set forth in the instrument of its appointment. So for a court-appointed receiver, the powers are set forth in the court order that appoints the receiver. For private appointments, they are appointed to a person with contractual rights, generally found in security agreements, although not necessarily, and then are governed by the relationship between the debtor and the creditor.

As you will see, court-appointed receivers are far more popular and commonly seen because they describe their powers from a court order. They become an independent court officer. They are able to deal with third parties. They have the benefit of a stay of proceedings, and are generally a more powerful tool in this area.

A private appointment is really only as powerful as the underlying contract. So if the debtor decides not to honor that contract—which generally arises in such circumstances where a receiver needs to be resorted to to begin with—the mechanism quickly breaks down. As well, the receiver under a private appointment is simply the agent of the debtor, and sometimes the secured party therefore has no independent or third-party status to deal with third parties to carry on a business and, as well, receives no stay of proceedings to protect it in the course of its administration.

Receivership mandates vary, and they're always as set forth in the instrument appointing them. So, generally speaking, receivers are appointed on behalf of secured creditors to liquidate the assets of the debtor, such that collateral can be monetized and secured parties paid out, although that's not necessarily the case. Receivers may also be appointed in certain circumstances where shareholders are having a dispute, and care and custody of the underlying corporate assets needs to be maintained until that dispute is resolved. In those circumstances, a receiver may also be appointed.

Debtor-in-possession restructuring is the next topic that we wanted to cover. There are two methods in which restructurings can occur in Canada: the CCAA, as we discussed earlier, or the BIA. When I talked about the Bankruptcy and Insolvency Act earlier, it was in the context of liquidations, but there is a separate section under that legislation dealing with proposals. And I'll describe the two processes generally, and then I'll touch on some of the major distinctions between restructurings under the two legislative regimes.

But in both of these restructurings, the debtor remains in possession and control of its assets—that's why it's known as a debtor-in-possession restructuring—and that's not unlike a Chapter 11 in the United States. The objective of making a filing is to emerge with an accepted plan of compromise and arrangement, as it's known under the CCAA, or a proposal under the BIA. And throughout the course of this restructuring period, there is a monitor or a trustee that oversees the process that is quite different from the U.S. processes. The trustee or monitor is typically a licensed accountant, a chartered accountant in Canada, who has significant bankruptcy experience. They stand as a third party, a court officer, and [are] charged with enhancing the communication and negotiation between the stakeholders, assisting the debtor with its reorganization, and generally reporting to the court on various matters that are occurring in the reorganization.

To take you through the debtor-in-possession restructuring process generally, from a sequential point of view, the very first thing that is achieved is a stay of proceedings. And when I go into this, let me back up and outline one of the major differences between the CCAA and the BIA. The CCAA is not a codification; it's in fact only about 25 sections long and really simply provides the framework to a court—a plenary jurisdiction in Canada—to grant orders that allow for a restructuring to proceed. So the result of that is that the process becomes quite flexible, but on the other hand, sometimes the

certainty of things is not quite as defined or refined as we see in a codification process.

The proposal process, on the other hand, is a codification and it outlines every aspect of the process that needs to be done, and, in fact, is designed for smaller companies that are restructuring because the infrastructure of a restructuring is already built and available, and it doesn't need to build every step of the process, which is generally what occurs in a CCAA process. Bear in mind—notwithstanding [the fact that] the CCAA provides great flexibility—there are various protocols and templates that are involved such that the process does generally follow a recognized convention and mechanism.

Anyways, taking you back to the sequence of events: The first major step is to obtain a stay of proceedings, not unlike Chapter 11 proceedings. In the CCAA, that is obtained by visiting a judge—a bankruptcy judge—and putting forth an affidavit that describes the background of the applicant debtor, the current financial situation, the circumstances which led to the applicant's current insolvency, a brief description of the various stakeholders that are going to be affected in the proceedings, and, if possible—sometimes time doesn't warrant it—a brief outline of where it hopes to take its restructuring plan.

The judge will then review that affidavit and, if it's satisfied that this company is eligible for protection under the CCAA, will grant an order. The order is generally about fourteen pages long and outlines what the debtor can and cannot do over the course of its restructuring. It also will empower a monitor—appoint a monitor and empower what that monitor's mandate is. It will also create, potentially, charges in favor of the professionals to ensure that they get paid through the process [and] charges in favor of directors and officers to ensure that their indemnifications going forward have some teeth and some security to them. And they also provide for DIP financing if that's the circumstances the applicant finds itself [in], and a variety of other issues will be dealt with in what is called an initial order. That initial order is typically sought on little or no notice, and so there is generally no opposition at those first applications.

A restructuring proceeding under proposal under the BIA proceeds in a materially different way. A single sheet of paper called a Notice of Intention to Make a Proposal is filed with the Superintendent of Bankruptcy, and that's the government official that governs the Bankruptcy and Insolvency Act. When that is filed, then the Superintendent of Bankruptcy issues a certificate of filing and an automatic stay, created under the legislation, is invoked by virtue of that process. So, as you can see, very distinct and different processes.

Backing up to the CCAA process, there are very few technical requirements. The debtor has to have indebtedness of at least \$5 million, and has to demonstrate or make a public admission that it is insolvent in its materials. Similarly, for applying for protection under the Bankruptcy and Insolvency Act, to file a proposal the debtor simply has to demonstrate that it's insolvent; because it's designed for smaller companies there is no debt threshold that it has to qualify for.

The next step that you'll see is the come-back application. The initial proceedings, recall, are done either by filing a piece of paper or by applying to a judge without notice to the creditors. Both of those processes require the debtor to send out notice that the filing has occurred and the stay is now in place. And in both processes, the debtor needs to apply back again, in front of the court, within 30 days of that first initial filing date, on notice to all of its creditors.

It is at that point that a variety of substantive matters are heard, this time on notice and with all stakeholders having an opportunity to put forward their positions, whether they have objections, whether they agree, or whether they are neutral on the process. So it is that come-back application, which has to occur 30 days from filing, that is probably the most contentious and difficult to manage in the process.

After that comes the negotiations from within this protective cloak of a stay, and whereby a plan is tabled and discussed and negotiated between the debtor and its various stakeholders. Ultimately, the plan—the objective of the plan—is to have all creditors agree on a type of compromise that will see them get more than if a liquidation were to occur. And through a variety of negotiations, this plan has been tabled and voted upon by all creditors in a class. You may have more than one class, depending on the legal and economic rights of the participants in that class. To have the plan accepted by a particular class of creditors, we need to achieve a double majority, which is prescribed under both pieces of legislation. That double majority means a majority of creditors by head and two-thirds by value, since every creditor has the opportunity to vote its

entire claim into the process.

If that is achieved, at all levels of classes, two-thirds by value and a majority by head, then the next step in the process is for the applicant to bring an application before the presiding bankruptcy court to have the plan sanctioned. And in that process, the court is presented with evidence demonstrating the process was complied with, was fair and reasonable, that the plans were voted upon in accordance with a fair and proper protocol, and accepted by the dual majorities that I described.

If that occurs, then the court will grant a sanction order, and the debtor is then empowered to implement the plan. And the plan, much like a Chapter 11 plan, can be as inventive as the author's imagination can carry them. And it may be implemented in an instant whereby fresh money is brought in and distributed to creditors, such as that the plan is immediately executed, or it may be based on performance that could occur over days, weeks, months, or even years.

Let me give you a little bit of a rundown of some of the distinctions between the two debtor-in-possession restructuring processes, the Companies Creditors Arrangement Act versus a proposal under the BIA.

We already talked about the fact that the CCAA is a court-designed process and the court will give orders that set forth the stay of proceedings, the protocol to be followed for the voting, various matters that occur during the course of the restructuring. It'll set out the DIP financing or approve the DIP financing, and grant super-priority charges to facilitate those kinds of charges, whereas the Bankruptcy and Insolvency Act proposal is a codification, and one merely has to review the rules and regulations set forth in the BIA, and they will get a very good idea of how the process is to occur. The flexibility, of course, that follows from these two methods is quite obvious, although we must say, in recent years, we've seen more innovative uses of the Bankruptcy and Insolvency Act proposals, so many of the tools originally developed to accommodate CCAA restructurings are now finding their way into BIA proposals by way of court orders.

I already spoke of the size of filings. The BIA proposal filings are typically much smaller, because they have a designed infrastructure, are cheaper and much more inexpensive to use.

Terminology varies to some degree between the two processes. The accountant that oversees the process of the CCAA is known as a monitor. Under the BIA, he's known as a trustee under a proposal. The plan of reorganization under CCAA is called just that: a plan of compromise and arrangement. Whereas, under the BIA, it's a proposal. The entry process that we've talked about is materially different. While one is quite easy—it's really filing a piece of paper—the other requires the compilation and swearing of voluminous evidence under a full and frank application for permission to enter into a CCAA.

Timing also changes, although it's similar in that both processes need to come back to court in the first 30 days. After that, timing differs dramatically. Under the CCAA, extensions to the stay can be achieved depending upon what is appropriate in the circumstances. So, it's been known that a seven-day extension may be granted while certain things needed to be done in a hurry, or alternatively, six-month extensions may be granted while the debtor went off and achieved other types of thresholds important to its restructuring. And that can go on forever if necessary, whereas the timing under a BIA proposal is much tighter. After the initial 30-day come-back application, an applicant can only get extensions for a maximum of 45 days and can only get, in aggregate, five additional months. So, they must have a proposal out of the reverse side of the process within six months. And if they can't, then they are deemed to have made an automatic assignment into bankruptcy. So, it is designed to be a more streamlined process.

I've already talked about the rigidity of the process. There are also some tax consequences that need to be taken into consideration. And sometimes larger reorganizations may adopt a BIA proposal structuring, just because there are certain ramifications in our Income Tax Act, but that's well beyond the scope of what we're talking about here.

We should also talk about the consequences of failure. If a CCAA plan, or even a restructuring, fails at any point in time, then there are no consequences other than the loss of the protection of the stay that's granted under the CCAA. Beyond that, the debtor is left right where it started, as an insolvent company. And, generally speaking, a creditor will solve that problem for them by putting them into receivership or bankruptcy.

A BIA, on the other hand—a BIA proposal—if a proponent at any course during its reorganization fails, then it will be deemed to have made an assignment in bankruptcy, and automatically be put into bankruptcy. If, on the other hand, they have proceeded to actually have a proposal accepted by its creditors, and sanctioned by the court, and it is then being implemented, and the debtor fails at that stage of a proposal, then that's deemed to be an act of bankruptcy by which a creditor could, if it wanted, bring an application and try and petition the proponent back into bankruptcy. So, there are significant differences in the consequences of a failure in the restructuring, in the two different restructuring processes.

So with that general overview of the insolvency processes that you are likely to see in a Canadian context, I'm going to turn it over to my partner, David LeGeyt. Thank you, everyone.

LESLIE GARDNER: And meanwhile, while we switch over presenters, I'd like to launch the second poll. Which Canadian province do you do business in? Is it B.C. (British Columbia), Alberta, Saskatchewan or Manitoba, Ontario, or another province? Please vote. I'll give it a little bit more time here; the votes are coming in. Slowing down, and we're just about done. I am closing the poll now, and here are the results: Zero percent in British Columbia; Alberta has 40 percent; Saskatchewan or Manitoba is 20 percent; Ontario is 40 percent. And now I'll hand it off to David. Thank you, all.

DAVID LEGEYT: Thank you, Leslie. And thank you, Dave Mann, for that very good overview.

My topics will be a little more specific, and one of the reasons we've just asked you which Canadian provinces you do business in is because some of the topics I am going to touch on will be different from province to province. Or the correct approach to take or the governing legislation will be different from province to province.

Canada has a federal legislative system. Our federal government is located in Ottawa, Ontario. There are 10 provinces, each with its own legislative capabilities. Under our constitution, it is our federal government which is competent to legislate in respect to bankruptcy and insolvency, and so the two statutes which Dave Mann focused on—the BIA and the CCAA—are federal statutes. They are applicable in all Canadian provinces and the case law, which is decided in the different provinces, is also applicable in other provinces.

The provincial governments are legislatively competent to legislate with respect to property and civil rights, and as a result there are differences between the provinces—sometimes small, sometimes large—with respect to other important legislative regimes such as for instance, the Personal Property Security Acts of the provinces. And at the risk of being blunt, it is important, if you are looking for local Canadian counsel in an insolvency, to find someone from the correct province, because there may be significant legislative or procedural differences between the provinces.

The first specific topic I am going to touch upon is directors and officers. I note from the first poll that a number of the listeners do have operations in Canada, either through a parent or a subsidiary. As you can see from the slide, there is a very different treatment of directors in a bankruptcy or a receivership compared to a reorganization under the CCAA or a proposal.

In a bankruptcy, the directors are immediately displaced. The trustee in bankruptcy takes over management of the company. In virtually every instance I am aware of, directors will immediately resign. They do have some statutory duties to cooperate with the trustee, provide information, and perhaps even be examined under oath. But for the most part, the directors' and officers' duties come to an end upon the bankruptcy.

It is very similar in a receivership. The receivership order will prescribe the receiver's powers, and the law states that where the receiver is given a power by the order, the directors are no longer capable of exercising that power or something ancillary to it.

Over time, the various provinces have developed a very thorough and lengthy receivership order, which covers virtually all management powers, and, therefore, once a judge grants that order, there is little—if not nothing—left for the existing

directors to do, and again, in most cases, they will resign. There are some exceptions in receivership. For instance, if the company wants to appeal the receivership order, then the pre-existing directors could do that. Or, if the company wanted to defend the action of the debenture holder or secured creditors, the existing management could do that. So, practically in every case, they end up resigning.

Obviously, if we have a debtor-in-possession proceeding under the CCAA—or the BIA in the form of a proposal—the debtor remains in control of its business and in possession of its assets, and it needs management. It needs people to run the business. So, in those cases, management will stay on with the company. That obviously leads to a more interesting dynamic and potential controversy, since the insolvency of the business often leads stakeholders and the courts to scrutinize the activities of directors and officers, both before and after the insolvency filing.

As a result, there have been a number of cases at all different levels in Canada which talked about what a director's role was and what its duties were and are when a company finds itself in insolvent circumstances. Some of those cases debated and came very close to deciding that the directors' duty when the company is in insolvent circumstances shifted, and the directors owed a fiduciary duty to the creditors of the company. Very recently, that debate—to the extent that it existed—was resolved by the Supreme Court of Canada, in the case that you see on your screen now. The court held that the fiduciary duty of directors is a duty to act in the best interests of the corporation. There is no independent duty to stakeholders or creditors. Very often, practically speaking, what is in the best interests of shareholders or creditors will also be in the best interest of the company, and therefore the directors' duties should be clear and do not conflict. But if those interests diverge, the directors' duty is to the corporation.

The test or standard to which directors and officers [are] held is set out here. It is favorable to management. It is what we call the business judgment rule. The court looks to see that reasonable decisions are made, not perfect decisions. And there is a quote at the bottom of the screen talking about how the courts are not well-suited, especially in hindsight, to determine whether the correct business decisions were made.

What may be important—what is important, and what is recommended when a company finds itself in insolvent circumstances, is to properly implement the processes of management. Lengthy deliberations and debate about the best course of conduct are advisable. Part of that is obtaining the proper legal and financial advice and any other advice that the board may need depending on the specialties or the abilities of the board. It may be that a special committee is required. If certain board members have special skills, they may be delegated certain tasks which the company requires.

Of course, independence issues are always very large. Directors should always be conflict-free. They should declare any conflicts which they have, and they should not participate in any decision-making processes where they are in a conflict. I think it's important that alternative courses of conduct are explored and analyzed to determine what is the best course and most beneficial for the company. And, especially where an insolvency is imminent or looming, it is important to document how the board made its decision, and frankly I think the board should document the various scenarios or alternatives that it has considered in reaching its ultimate decision.

Once a company goes into protection under the CCAA or the BIA, there are some protections for directors and officers, either under the statutes or in the orders which may be granted by the court. Very often there is a pre-existing indemnity from the debtor company, and if not, those may be created by the court. And in either case, the court may secure the directors' indemnity against the assets of the company by a directors' charge or a directors' and officers' charge under the initial order. The court has the power to stay any proceedings that might be taken against directors and officers in respect of liabilities that they may incur simply by virtue of holding those offices. In Canada, there may be director liability for unremitted source deductions under the Income Tax Act, or the act which gives us GST, which is goods and services tax. And directors may also be personally liable for unremitted wages, and that differs from province to province. So, the court may stay any proceedings that could be taken against the directors and officers for those things, and it may indemnify the directors and officers for those types of liabilities.

There are exceptions, as we set out here. The court cannot protect directors from any contractual liability [they] may have, nor may the court protect directors from any liability they may have which is based in misrepresentation or oppression. And, as we say at the bottom of the slide, claims against directors may, in fact, be compromised in the debtor's plan of

arrangement. Again, the same exceptions apply. Claims based on breach of contract, misrepresentation, or oppression cannot be compromised.

Switching gears, I am going to talk a little bit about the treatment of executory contracts in insolvencies. I believe the definition is probably just the same as it is in the United States. An executory contract is an ongoing contract which requires periodic supply of goods or obligations to be exchanged between the parties. The main aspect of a stay of proceedings, as it relates to executory contracts, is that it prevents the counterparty from terminating the executory contract, which has the effect of requiring a supplier or counterparty to continue along with the contract notwithstanding debt. Virtually every contract talks about how the insolvency of the counterparty is breach of the contract. That's the bad news for counterparties.

The good news is that in Canada, under CCAA reorganizations, the statute expressly provides that no one can be compelled to give credit to the debtor company after it has made its filing. And that allows a counterparty to demand performance assurances which are satisfactory to the counterparty. So the executory contract stays in place. It cannot be terminated. Its terms cannot be changed, with the exception of the credit terms. And that is quite powerful because the counterparty can impose totally self-serving and one-sided credit terms. It is common that we see suppliers require COD or security deposits, and there is not much the debtor can do about that.

Set-off is always important, and may exist where there are executory contracts, because obligations flow both ways between the parties. A set-off is very different in Canada than it is in the United States. In a nutshell, set-off is simply allowed by both the BIA and the CCAA. And those statutes both say that set-off between the parties is permitted, notwithstanding anything else in those enactments. So, if you are wondering whether you have set-off in an insolvency against a debtor, you simply need to determine whether you are entitled to contractual set-off, legal set-off, or equitable set-off, without reference to any insolvency filing. And if you are, you can simply effect the set-off. And I understand that's a significant difference on our side of the border as well. I believe there is considerable procedure that is required in the United States, which effectively requires an application to the court for the lifting of the stay and the allowance of the set-off. We don't have to do that here. We simply do it. Often that leads to subsequent litigation, because the debtor company can always take the position that the set-off is not permissible and drag the counterparty into court, but if the debtor does not do that, then the counterparty doesn't need any relief and can simply effect the set-off.

We should spend a moment talking about eligible financial contracts. I believe the treatment of EFCs on both sides of the border is very similar. In Canada, both the BIA and the CCAA define what EFCs are. And if your contract falls within that definition, the stay of proceedings does not apply to the EFC, and the parties are allowed to exercise their contractual rights, which, typically, is terminating the contract and the netting of the obligations thereunder, giving rise to either an amount payable or owing by one party to the other.

I believe that that is very similar to the way things work in the United States. There is a procedural point in Canada, which is important, and contrasts nicely with what I just said about set-off. The prudent course of action is to first apply to the court for a declaration that you have an eligible financial contract and that you don't leave it to the court to terminate it. There is one fairly recent example in Alberta in the Calpine restructuring where a counterparty thought it had an EFC and it simply terminated. The debtor company disagreed and sought relief from the court, and it turns out the debtor was right and the counterparty was wrong. The contract was not an EFC and a very large damages claim was awarded to the debtor as a result.

Moving down the list. Sometimes as part of the restructuring the court will specifically authorize the debtor to enter into certain approved contracts. That achieves a little higher level of protection, because the court has approved those contracts. And then there may be court-ordered charges for the ongoing supply of goods, in particular. The court will sometimes grant what is called a post-petition trade creditor's charge. And it will allow that charge to exist in a certain amount and grant a charge against the debtor's assets to secure that liability.

Supplier's rights. Based on the initial poll question, it looks as though a number of you may be suppliers to Canadian companies. I'll touch briefly on supplier security on inventory. This would be one of those areas where provincial law governs, and you will most certainly need a lawyer from the correct province to take your security. In Alberta, under our Personal Property Security Act, it is possible for an inventory financier to obtain what is called a purchase money security interest. And that is a super-priority charge against the inventory finance. There are a number of very technical requirements

for registering that security and for giving notice to pre-existing secured creditors, and a number of other technical things. I'll simply bring that to your attention, but I won't get into the details behind that.

Under § 81.1 of the Bankruptcy and Insolvency Act, an unpaid supplier of goods has the right to repossess those goods. Again, it is very technical, and should you not be able to comply with the statute for any reason, you won't be able to repossess the goods in question. The goods need to be sold to a debtor who becomes bankrupt or goes into receivership. The unpaid supplier then needs to make a written demand for repossession of the goods supplied within 30 days of delivering the goods to the purchaser, and the goods must be identifiable and unchanged. In those circumstances, the supplier can retrieve his goods and the statute gives him priority over anyone else. But if you are outside the technical requirements of the act, you cannot obtain that relief.

We have talked a little bit about post-filing charges and performance assurances. Those are important but I won't repeat myself there, as we're getting a little short on time. The concept of critical suppliers is very different in Canada. My understanding is that in the United States, it is a heavily codified part of the statute. There is no such statutory language in Canada. And in fact, until recently, a critical supplier designation by the court was extremely rare. Until recently, I was aware of only one case. However, there have recently been about three CCAA courts that have granted initial orders allowing for the payment of critical suppliers with the approval of the monitor. So, stay alert to that concept. It may be gaining favor and I think it should be watched carefully, because if you are a supplier and if we couple the concepts of being a critical supplier, which allows you to be paid your pre-petition debt, with the concept of payment assurances, which allows you to demand COD going forward, suppliers could find themselves in a very favorable position, effectively being paid in full.

I wanted to talk about acquisitions very quickly. And the reason this slide is on here is simply to remind you that you don't always have to be passive when an insolvency occurs. You can use these processes to acquire assets which may be attractive to your business. In fact, you can acquire entire businesses through the insolvency process, you can acquire tax losses, or whatever you may be looking for. In all of our processes, the courts by order usually establishes a procedure for bids involving deposits, deadlines, things of that nature. The stalking horse process is recognized in Canada, and there is often a break fee associated with that, which again is not statutory here, but I believe is effectively similar to what happens in the United States. And where assets are purchased out of an insolvency, the court will grant what we call a vesting order, which transfers title to the assets free and clear of any claims of creditors. And those assets are usually transferred without any representations or warranties, as well.

In Canada, debtor-in-possession lending—or DIP financing—is not codified, however pursuant to our common law, it is alive and well in both CCAA reorganizations and proposals under the BIA. The DIP lender is virtually always given super-priority security against the assets of the debtor company. In some cases, the DIP lender even gets priority over the [administrative] charge, which secures the fees of the trustee or monitor or counsel to the debtor company. There are some advantages to being the DIP lender. There is an enhanced perspective; essentially you become inside the tent of the reorganization, and it's good to be inside that inner circle. And, if you are in the business of lending, as you know, the pricing can be quite favorable for DIP lending.

I want to leave a few minutes for questions, so I won't get into legislative reform in great detail. The BIA and the CCAA have been worked over by the federal government in Canada. Those legislative changes have come into force or become effective slowly over about the last year, and the final ones will become effective on September 18 [2009]. The legislative changes will codify debtor-in-possession financing. The legislative reform will actually allow creditors in certain circumstances to remove directors and management and appoint new people. I think that could be quite a powerful tool for creditors in the insolvency, and that's a brand new development in Canadian law, so that's should be interesting. And there will be a change to the definition of eligible financial contracts to make it more of a conceptual definition. The definition presently simply lists a number of contracts, such as swaps and collars and things like that, which clearly are EFCs, but the new definition will be more conceptual and less of a list. So, hopefully, we have a few minutes for questions.

NICOLE SPAUR: This is Nicole. I will go ahead and jump in here with some questions for both of you. First of all, thank you to you both. Great job. Also, if any of our audience members do have questions, feel free to use the question tool in your control panel to send those in. But I'll get it started. And these questions are not for a particular speaker, so either David,

please feel free to jump in. The first one: What are the first few steps that a U.S. creditor should take when it learns that its Canadian counterparty may be, or has, filed bankruptcy?

DAVID LEGEYT: Well, I would think that gathering information is always important. In Canada, there will be a trustee or a receiver or monitor. That person is neutral, and is often a very good source of information. It's usually one of the big accounting firms, so it may be a less recognizable name. So I think you need to gather information. You need to keep the lines of communication open with the debtor, and, of course, I think you need counsel in the jurisdiction where the filing is. Dave?

DAVID MANN: Yeah, I guess the first thing I would do, as David suggested, is talk to the insolvency practitioner who is in charge and determine what process you are dealing with, whether it is a reorganization, a receivership or a bankruptcy. Because the consequences are slightly different, depending upon what mechanism you are under. Then, I think you want to take a look at the nature of your agreement. Is it an eligible financial contract or a forward contract in the United States, such as you would have immediate rights of termination? Is it an executory contract that requires continued performance and may be captured by some form of stay? Do you have the ability to stop your goods in transit if you are a supplier? Do you have supplier rights under § 81.1? Something like that you've got to move on very quickly, because the moment the identity of those goods are lost, your rights are lost. And you shouldn't lose track of the fact that if you are trapped in an executory contract, you probably need to hold the phones and get some sort of a performance assurance before you continue to deal with somebody who is insolvent or otherwise suffering.

NICOLE SPAUR: Excellent. OK, second question. This one—you didn't really touch on this in your presentation, but I think that it's just a related question. Many energy companies request security from their counterparties and sometimes that security is in the form of cash collateral. Could you talk a little bit about how one would go about perfecting its security interest in cash collateral under Canadian law?

DAVID LEGEYT: Dave, do you want to start on that one?

DAVID MANN: I can. Typically cash is perfected by possession, so when you are dealing with an eligible financial contract or other sort of trading contract and you're taking collateral, you would take physical possession of the cash. There are new rules in our personal property legislation that allow that to occur. Our Personal Property Act is similar in concept to the UCC [Uniform Commercial Code] in the United States. So that is possible to achieve, as well. David alluded to amendments that were being made under the Bankruptcy and Insolvency Act, and those touch on taking cash collateral under eligible financial contracts, and give them safe harbor against review of preference attacks. So, that is all fairly handy. One of the other things that you should remember when taking that kind of performance assurance is: You may also want to consider getting an LC [letter of credit] that remain by and large above the fray in any Canadian insolvency proceeding and allow you to have direct access to liquid recourse if you find you're out of the money or otherwise insecure.

NICOLE SPAUR: Great, OK.

DAVID LEGEYT: Yeah, and I would just add—sorry—under our eligible financial contract or forward contract regime, part of terminating the contract and netting it out, the legislation also says you can apply any collateral that you hold.

NICOLE SPAUR: Oh, great. Good to know. In terms of physical possession, is there any distinction between holding it in a bank account versus actually having physical possession?

DAVID MANN: As long as it's not the borrower's bank.

NICOLE SPAUR: OK, I have one more question that we have. The third one is: Can you discuss whether bankruptcy courts in Canada have upheld contractual set-off rights that allow a creditor to offset what a debtor owes it against, for example, what the creditor and its affiliates owe the debtor, so kind of getting into affiliate set-off, and is that possible and will that be upheld?

DAVID MANN: Dave, you want me to jump in on that one?

DAVID LEGEYT: Sure.

DAVID MANN: There was recently a decision in the Alberta courts that was not friendly to issues of tripartite or four-corner set-off. And the courts sort of reiterated the traditional foundations of set-off, requiring mutuality, and then depending whether it's legal or equitable, a close connection. There has been considerable effort here to be putting together master netting agreements, which would create offsetting obligations directly between the various affiliates, so that you could get yourself more in a conventional mode of creating set-off. And I think people, by and large, are starting to feel fairly comfortable about that. But, as of yet, there has been no judicial commentary on that.

Another mechanism that has also been contemplated is the conditional payment mechanism. In other words, you don't have to pay until they have paid you and all your gang everything that they and their gang owe you and your gang, and whether you can then rely on that condition to hold off any payments. So, it's sort of a practical set-off but not really. Again, commentators have developed some confidence in that approach. We've seen a little bit of peripheral comment in some cases, but nothing yet that I think one would go to the bank on.

So the answer to your question: Tripartite set-off is not making much headway here, but the solicitors and the head-scratchers are slowing divining mechanisms that we are hopeful will ultimately make that achievable.

NICOLE SPAUR: OK, fantastic. Well, I think with that we have probably reached the end of our hour. Again, I want to thank both David Mann and David LeGeyt for being with us today and giving a wonderful presentation on a very timely topic. I am going to turn it over quickly to Leslie. As you all know, our participants, she is going to provide to you the second verification code that you will need. So, thank you all for joining. And with that, Leslie?

LESLIE GARDNER: Thank you, Nicole. Thank you, everyone.

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And now, on behalf of the Association for Corporate Counsel and SmartPros Legal and Ethics, I want to thank you again for listening to today's program.

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I want to thank everyone. Have a great day.

And that concludes our show.