



Essentials of Insolvency Presentation to the Association of Corporate Counsel

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Wherever business takes you

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Outline

- Warning Signs
- Business Life Cycle
- Loan Recovery Options
- Types of Insolvency Proceedings
- Things to Consider
- Questions

Warning Signs

External Signs

- Economic: \$, interest rates, commodity prices
- Legislative: tax credits, environment
- Structural: Trans-Pacific Partnership Agreement, USMCA
- Competitive: India, China
- Unforeseen events/natural disasters (COVID-19, world oil price collapse)
- Loss of key customers

Warning Signs

Internal Signs

- Management and relationships – employee turnover (including “C” suite)
- Distracted management
- Unsophisticated management
- Aggressive expansion
- Business Issues

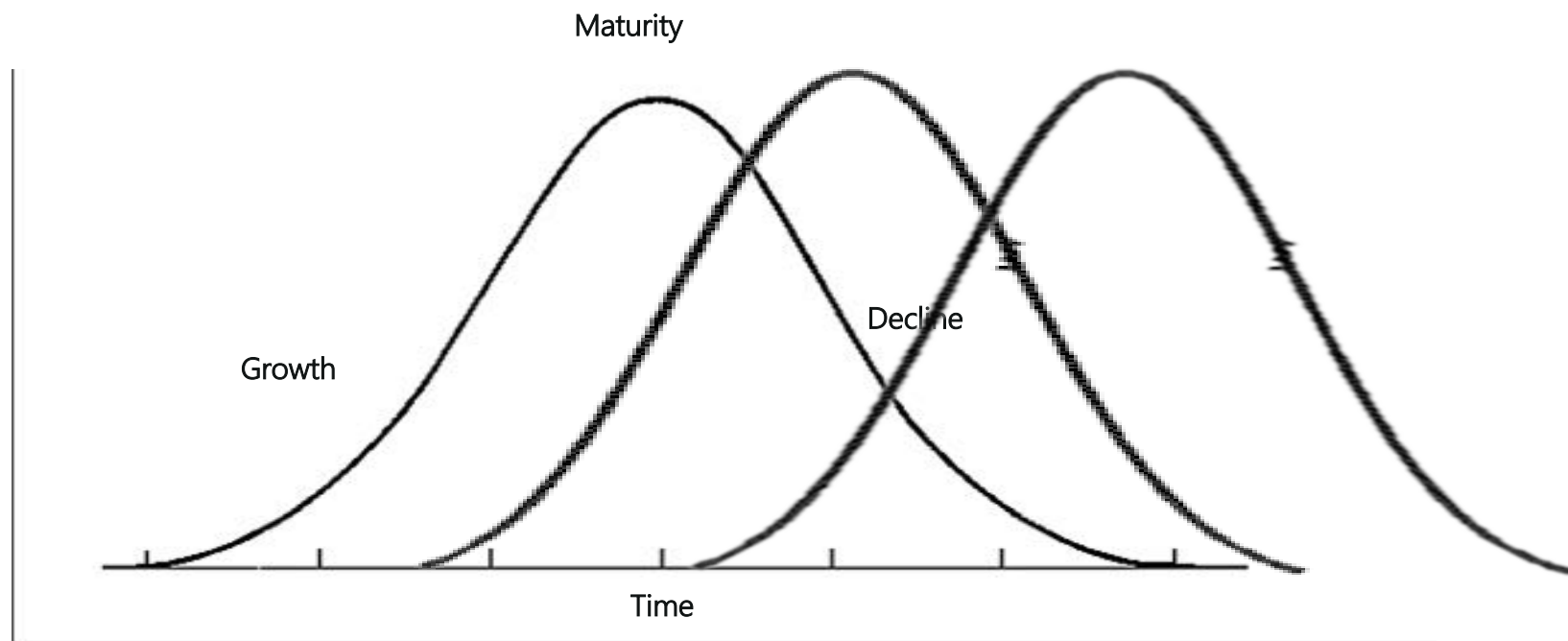
Warning Signs

Internal Signs (cont'd)

Financial

- Reporting – timely, accurate, consistent?
- Results – historic, actual to forecast
 - Losses
 - Unpaid government remittances?
 - Deteriorating balance sheet
 - Cash flow shortfalls, payable ageing, liquidity
 - Covenant breaches

Business Life Cycle



Secured Creditor Loan Recovery

When a secured creditor considers enforcing on a loan they would typically:

- Review of security – any issues?
 - Review of priority creditors
 - Demands and other notices – 10-day notice unless debtor consents or emergency action approved by court
 - Understand worst case recovery scenario and asset particulars
- Restructuring and insolvency environment is the intensive care unit of the corporate world.
- It is intense and an art, not a science.

Options for Secured Creditors

- Sale of security at a discount
- Support a Restructure business (typically in cooperation with management)
 - Informal restructuring
 - Formal (BIA proposal or CCAA)
- Sale of all or part of the business through BIA Proposal, CCAA, or receivership
- Wind down
- Liquidation

Sale of Business



Often, to maximize value, buyer requires business continuity (customers, contracts, key people-developers and customer contacts)

If business is insolvent how best to maximize value, complete sale and minimize intrusion?

What is the realization process - receivership, BIA or CCAA restructuring?

Insolvency Proceedings

Definition of Insolvency

Being unable or unwilling to pay debts as they generally become due

or

The net realizable value of the assets are insufficient to pay the obligations.

Insolvency Proceedings

- Early recognition of circumstances and a proactive response will maximize options and opportunities
- Options can be used by all stakeholders to meet a variety of objectives
- The option chosen needs to be supported and clearly understood by all parties to maximize outcome
- If there is no cooperation among the stakeholders, some options will not be available, and costs will likely increase

Types of Insolvency Proceedings

- Informal Restructuring
- Bankruptcy
- Receivership
- Division 1 Proposal
- CCAA (Companies Creditors and Arrangement Act)

Insolvency Proceedings

Informal Restructuring

Secured creditor imposed

- Debtor and lender(s) enter into forbearance agreement with an agreed plan to bring business back into good standing or find replacement financing
- Normally includes a timeline with critical milestones
- Lender(s) usually appoints a monitor to ensure debtor is complying with the agreement and to monitor results

Insolvency Proceedings

Informal Restructuring

Secured creditor imposed (cont'd)

- Reaffirmation of debt
- May need dialogue with critical suppliers and other creditors to have them provide support and perhaps also with customers
- Full informal restructurings are difficult to complete, i.e. with compromise of all creditor claims
- Could include provision for a sale process, wind-down or liquidation to be concluded via insolvency process

Insolvency Proceedings

Bankruptcy

- Insolvent debtor assigns its property to a Trustee to be realized for the benefit of creditors or Bankruptcy Order issued pursuant to a petition filed by a creditor
- Subject to the rights of secured creditors
- Inspectors are appointed
- Trustee has investigative powers
- Ability to invert certain priorities, e.g. GST, WCB, PST, HST and landlord claims
- Lose tax losses;
- Trustee has various rights re: occupying, using and conveying leased premises
- Ability to assign contracts

Insolvency Proceedings

Court Appointed Receivership

- Typically on the application of a secured creditor, however, can be on application of other stakeholders
- Court Appointed Receiver represents interests of all creditors and reports to Court
- Receiver's powers are prescribed by the appointing Court Order
- Approvals of all significant actions by the Receiver requires Court approval
- Vesting order available to transfer assets to buyer free and clear of claims; and
- Cross border recognition

Insolvency Proceedings - Restructuring

Debtor Objectives for filing either a BIA Proposal or CCAA

- Live to fight another day
- Retain employees – may require a KERP
- Operational restructuring
 - Downsize (core business)
- Legacy issues
- Provide a balance sheet that would support fresh financing/investment
- Strategic partner
- Equity investor or sale
- Exit with dignity – maximize recovery

Restructuring

From a Lenders Point of View

- Stay or Exit?
 - Identify causes - Is there a fix?
 - Confidence in management (skills, motivation, stress)
 - Understand security position under various scenarios
 - External collateral
- Rehabilitate problem loans rather than enforce
 - Institutional policy and public pressure

Restructuring

From a Lenders Point of View (Cont'd)

- Support a restructuring
 - Confidence in restructuring team
- Funding requirements
 - Is the plan realistic
 - Exit financing
 - Monitoring and ongoing security position

Restructuring

Investor Objectives

- Strategic vs. financial
 - Strategic - synergies, growth, supply, integration
 - Financial - funds looking for home, rate of return, growth, turnaround
- Equity position/control, management, exit strategy
- Buy troubled loans at a discount and then take control of the restructuring process potentially with the cooperation of the debtor

Insolvency Proceedings- Restructuring

Division 1 Proposal under the BIA

- A debtor files a notice of intention to file a proposal with a Trustee
- Maximum extension of 6 months to file a proposal
- Monitoring and reporting by trustee
- Inspectors are appointed
- Creativity - statutory requirements
- Proposal must be approved by unsecured creditors having majority in number and 66 2/3% of dollar value and by the Court
- If rejected – automatic deemed bankruptcy

Insolvency Process – Director Objectives

- Acting in fiduciary duty to the corporate entity;
- Assessing management team's ability to navigate insolvency process and consider CRO hiring or other expertise;
- Director Liabilities for certain corporate debts (CRA payroll and GST, wages, environmental);
- Adequate D&O insurance in place with resources to continue paying premiums during insolvency process;
- Director Due Diligence defense for CRA claims.

Insolvency Proceedings

Division 1 Proposal (cont'd)

- Need for support from customers, suppliers and employees
- Secured creditors can be included but the unsecured carry the vote
- Can disclaim commercial property leases
- Used for tax loss sales
- Directors obligations may be absolved should the proposal compromise a statutory claim
- Streamlined version of CCAA but not as flexible; and
- Trustee to review creditor claims and paying dividend

Insolvency Proceedings- Restructuring

Companies Creditors Arrangement Act ("CCAA")

- Company must have debts of at least \$5 million
- Typically larger, more complex and expensive
- Stays all proceedings
- DIP financing
- CCAA only 63 sections - flexible interpretation by Courts
- Monitor appointed to be the "eyes and ears" of the Court

Insolvency Proceedings

Companies Creditors Arrangement Act ("CCAA") (cont'd)

- The Court Order stipulates obligations of the debtor and the monitor
- Directors and officers charge can form part of the CCAA Court Order
- CCAA stay can be extended for so long as the Court is satisfied that it remains in the best interest of the stakeholders
- Plan of compromise or arrangement - voted on by class of creditors and must be approved by majority in number and 66 2/3% of dollar value and the Court
- Public perception (Air Canada /Stelco/Nortel); very expensive process; and
- Cross border recognition

Insolvency of a Major Supplier

Considerations if a major supplier finds itself in a formal insolvency process:

- What type of product (being manufactured, international shipment, specialized product);
- What are the payment terms (deposit, progress billed, purchase order);
- Warranty / Guarantee provisions;

Insolvency of a Major Supplier

Options by Insolvency Process

Bankruptcy/Receivership

- dealing directly with Receiver/Trustee;
- If manufactured product possible for Receiver/Trustee to complete production (will require commitment for payment and likely delivered on a no guarantee/warranty basis); and
- If product in inventory possible to purchase directly from Receiver/Trustee (or ultimately at auction)

Restructuring Process (Div 1 or CCAA)

- Review payment terms (COD);
- If manufactured product quality assurance on status of production and confirmation of ownership of drawings/plans;
- If construction related, has supplier (sub) provided statutory declarations, are there lien risks?

Insolvency of a Major Customer

Considerations if a major customer finds itself in an Insolvency Process:

- What type of process are they in?
- Have you delivered goods to the customer within 30 days of the filing (timing can be important);
- Are you a key supplier to the customer (specialized service/product);
- Is there a contract involved;
- If it is a manufactured product, what are the payment terms?
- If it is a restructuring process, how strong is the management team;

Corporate Recovery

THOUGHTS / QUESTIONS?



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