AMENDMENTS TO THE *BANKRUPTCY AND INSOLVENCY ACT* AND THE *COMPANIES' CREDITORS ARRANGEMENTS ACT* TRANSFER, PREFERENCES AND OTHER ISSUES

Presented to the Saskatchewan Association of Insolvency and Restructuring Practitioners
September 8, 2009

A. INTRODUCTION

This paper will focus on those amendments to the *Bankruptcy and Insolvency Act* ("BIA") and the *Companies' Creditors Arrangements Act* ("CCAA") coming into force on September 18, 2009, which relate to:

a) Preferences and transfers at undervalue;

b) other issues relating to non-arms-length relationships; and

c) several miscellaneous provisions not otherwise covered during the course of the seminar.

B. RELATED PERSONS

Much of the following discussion touches on the concept of "Related Persons".

There is an extensive definition of "Related Persons" set forth in section 4, based upon blood relationships, marriages, common-law partnerships, adoption, and control of corporations. These provisions cast a broad net, and should be reviewed whenever there is some degree of proximity between persons involved in bankruptcy matters.

The definitions have been amended, in large part, to replace the concept of a "corporation", with that of an "entity". An entity is now defined as a person other than an individual. Otherwise, the definitional amendments do not appear to be substantive.

Of particular note for the purposes of this paper, two subsections have been added to subsection 4.

Subsection 4(4) provides that it is a question of fact whether persons not related to one another at a particular time were dealing with each other at arms length.

Subsection 4(5) provides that persons who are related to each other are deemed not to deal at arms length while so related, and in particular, for the Transfers and Preferences provisions discussed later. This presumption will apply in the absence of evidence to the contrary.

C. PREFERENCES AND TRANSFERS AT UNDER VALUE

Sections 91 through 101 of the BIA were formerly titled "Settlements and Preferences". The heading is now appropriately renamed "Preferences and Transfers at Undervalue".

Section 91 is repealed in its entirety, and the concept of settlement appears to have disappeared from the Act. This leaves open an interesting question as to whether the existing case law on "self-settlement" will be adapted to the new provisions, or whether the concept is no longer relevant in bankruptcy.

Preferences

The new section 95 treats arms-length transfers largely as before. Under section 95, a transfer of property, a provision of services, a charge, payment, obligation incurred or judicial proceeding taken or suffered by an insolvent person may be set aside where:

a) the Transferor is insolvent at the time of transfer;

b) the transfer is made with a view to prefer; and

c) the transfer is made within three months of the initial bankruptcy event.

The new section 95 retains the reverse-onus provision governing intent. If the transaction has the affect of giving the creditor a preference, it is, in the absence of evidence to the contrary, presumed to have been made with intent.

A more substantive change made to section 95 arises in the case of non-arms-length transactions. There is no longer a need to prove intent. Where the impugned transaction is made with a party which is not at arms-length, the transaction will be set aside where the transaction:

a) has a preferential affect; and

d) is made within 12 months of the initial bankruptcy event.

Transfers at Undervalue

Section 96 replaces the concept of a "reviewable transaction", with the concept of a "Transfer at Undervalue".

A Transfer at Undervalue is defined in Section 2 of the BIA as:

> "A disposition of property or provision of services for which no consideration is received by the debtor, or for which the consideration received by the debtor is conspicuously less than the fair market value of the consideration given by the debtor."

Under the new section 96, where the parties deal at arms-length, on application by Trustee, the court may declare a transfer void, where the Trustee shows:

a) the transfer was at undervalue;

b) the transfer occurred within one year of the initial bankruptcy event;

c) the debtor was insolvent at the time of transfer, or rendered insolvent by the transfer; and

d) the debtor intended to defraud, defeat or delay creditors.

This intent must be proved. There is no reverse onus provision in section 96.

There is a substantially broader power to intervene where the parties are not at arms-length. There, the Trustee need only prove to the court that:

a) the transfer was under value; and

b) the transfer occurred within a year of the initial bankruptcy event.

Alternatively, if the impugned transaction took place outside the one year limitation, it may still be attacked successfully by the Trustee, where the Trustee can prove:

a) the transfer was undervalue;

b) the debtor was insolvent at the time of the transaction or rendered insolvent thereby, or intended to defraud, defeat or delay creditors;

c) the transfer took place within five years of the initial bankruptcy event.

Section 96 provides for an expedited process for establishing value. For the purpose of the application, the Trustee is to value the consideration given by the debtor, and the consideration received by the debtor. In the absence of evidence to the contrary, the Trustee's valuation is to govern.

Remedies

The remedies arising from sections 95 and 96 are partly contained in the amendments, and partly contained in unamended portions of the Act.

Section 95 simply provides that a preference is void as against the Trustee. The remedy is set forth in Section 98. Subsection 98(2), unamended, provides that the Trustee may recover the property, the value thereof, or money or proceeds from the person who acquired it from the bankrupt, or to any other person to whom it may have been transferred as fully and effectually as the Trustee could have recovered the property if it had not been so sold.

Section 98 further provides as follows:

a) where a person has acquired property of a bankrupt under a void or voidable transaction, and is sold, disposed of, realized or collected the property, all proceeds thereof are the property of the Trustee;

b) the Trustee may recover the property or the value of the property, or proceeds, from the person who acquired it from the bankrupt, or from any other person to whom he may have resold, transferred or paid over the proceeds of the property as fully as the Trustee could have recovered the property as if it had not been disposed of; and

c) where there is consideration remaining payable on any sale or resale of the property, and any part remains unsatisfied, the Trustee is subrogated to the rights of the vendor.

The foregoing is limited by subsection 98(3), which provides protection to any person dealing with the property in good faith for adequate valuable consideration.

In the case of section 96, the first remedy available in the case of a transfer under value is to proceed on the basis that the transaction is void, and make use of the aforementioned remedies.

The alternative remedy, set forth in section 96, is for the court to order that a party to the transfer, or any person privy to the transfer (being a person who has obtained a benefit, or causes a benefit to be received by another person) shall pay to the estate the difference between the value of the consideration received by the debtor, and the value of the consideration given by the debtor.

Proposals

Section 101.1 now provides that sections 95 to 101 apply to a Division I proposal, unless the proposal should provide otherwise.

New section 101.1 provides that a reference in sections 95 to 101 to be date of the bankruptcy is to be read as a reference to the date upon which a Notice of Intention is filed, or if a Notice of Intention is not filed, as a reference the date upon which the proposal is filed.

Under amended subsection 50(10)(b), the Trustee must now report on the reasonableness of the decision to include in a Division I proposal a provision that Sections 95 to 101 do not apply with respect to the proposal.

Transitional

Pursuant to the provisions of section 133, the revised Sections 95 and 96 do not apply where the initial bankruptcy event occurs before September 18, 2009.

CCAA Provisions

New subsection 36.1 adopts sections 38 and 95 to 101 of the BIA, and provides that they apply unless a compromise or arrangement specifies otherwise.

Subsection 36.1 also provides that a reference in the BIA to the date of the bankruptcy is, for the purposes of the CCAA, the date upon which proceedings begun under that Act.

Subsection 23(1)(d.1) now requires the Monitor to report at least seven days prior to the meeting of creditors on the reasonableness of any provision in a Plan of Arrangement or Compromise that sections 95 to 101 of the BIA do not apply in respect of the proposed arrangement or compromise.

E. PROPOSALS – VOTE OF CREDITORS

The matter of arms-length relationships also arises with respect to the voting by creditors on a proposal.

Under subsection 109.6 where the Chair of a meeting of creditors should determine that the outcome of the vote was determined by a creditor who did not deal arms-length with the debtor during the year preceding the initial bankruptcy event, the Chair shall re-determine the outcome by excluding that creditor's vote.

Where an interested party makes application within ten days of the re-determination, such determination may be reversed, if the court considers it appropriate to include the vote of the non arms-length creditor.

F. ASSET SALES

For the better part, asset sales in the context of the BIA and CCAA have been governed by common law arising from the court's inherent jurisdiction, and extrapolation of the intent of the present legislation.

There are new express provisions in the BIA and CCAA which will govern the sale of assets.

Asset Sales – Proposal/CCAA

Pursuant to section 65.13 of the BIA (Section 36(1) of the CCAA), a debtor subject to a Stay of Proceedings in a proposal or CCAA process may not sell or dispose of assets out of the ordinary course of business, and without court authorization.

This is a new express statutory provision. These provisions are consistent with the established CCAA practice in Saskatchewan, as set out in the Template Initial Order.

The new provisions provide that the court may authorize a sale, even where there has been no shareholder approval.

Where an individual carrying on business is the subject of an application to sell assets, the court may only grant an order with respect to those assets purchased for use in the business.

Notice must be given to secured creditors likely to be affected.

In determining whether to approve a sale, the matters to be considered by the court are set forth in subsection 65.13(4) of the BIA, and subsection 36(3) of the CCAA. Without limiting consideration of other factors, the court will look at the following:

a) was the process leading to the sale fair and reasonable;

b) did the Trustee/Monitor approve the process;

c) has the Trustee/Monitor filed a report stating an opinion that the sale or disposition is more favourable than would be a sale in a bankruptcy;

d) the extent of consultation with creditors;

e) the effect of the sale on creditors and other interested parties; and

f) is the consideration to be received fair and reasonable.

Again, the concept of Related Parties arises.

Where a sale order is sought in the context of a proposal or CCAA proceeding, and the sale would take place to a Related Party, subsection 65.13(5) of the BIA, and subsection 36(4) of the CCAA provide that the sale may take place only if the court is satisfied that:

a) good faith efforts have been made to sell to an unrelated party; and

b) the consideration received is superior to the consideration which would be received under any other offer made in accordance with the sale process.

Where the debtor is an employer, subsection 65.13(8) of the BIA and subsection 36(6) of the CCAA provide that the court may only grant authorization if it is satisfied that the insolvent person or debtor company can and will make the payments required for unpaid wages and unpaid pension plan contributions where the court sanctioned the proposal, or compromise were granted. Those requirements are set forth in subsections 60.13(1.5) of the BIA, and subsection 6(4) and (5) of the CCAA.

Sales by Trustee

The amendments do not substantively touch on a sale by a Trustee to an unrelated party. However, where the Trustee contemplates a sale to a party which is related to the bankrupt, court approval is required (Section 30(4)).

The test for court approval is, essentially, a combination of the previously discussed requirements for a sale within a proposal or CCAA proceeding:

a) was the process reasonable in the circumstances;

b) were the creditors consulted;

c) what are the effects of the proposed sale on creditors;

d) is the consideration reasonable and fair taking into account the market value of the property;

e) were good faith efforts made to sell or otherwise dispose of the property to unrelated persons; and

f) is the consideration to be received superior to the consideration received under any other offer made in the sale process.

Note that, unlike the situation governing a sale in a proposal or a CCAA proceeding, the last three matters are simply considerations and are not mandatory.

G. STAY OF PROCEEDINGS – REGULATORY BODIES

For the purposes of the amendments, "Regulatory Body" is defined as a person or body with powers, duties and functions relating to the enforcement of federal or provincial enactment, or as prescribed for the purposes of such act.

Section 69.6 of the BIA (CCAA Section 11.1) provides that no stay of proceedings shall affect the ability of a Regulatory Body to investigate the debtor or insolvent person, or shall affect any action, suit or proceeding taken before the Body.

The stay of proceedings will affect enforcement of any order to pay made by the Regulatory Body.

An exception arises where the insolvent person or debtor should apply to have the stay extended to the regulatory body, and the court concludes that:

a) a viable proposal or arrangement cannot be made if there is no stay of proceedings; and

b) it is not contrary to the public interest that the Body be affected by the stay.

H. ACTING FOR A SECURED CREDITOR

New subsection 109(6) provides that a Trustee may not act for a secured creditor in asserting a claim against the estate unless the Trustee has obtained an opinion from *independent legal counsel* that the security is valid and enforceable against the estate.

This is a change from the former provision which stated that legal counsel could not be counsel employed by the secured party. The original intent, as noted from the briefing notes prepared for the senate, was that a concept of "independent" legal counsel would mean that the counsel could not have done any work for the secured creditor during the two years preceding the initial bankruptcy event. This was apparently deleted as a result of a concern that it unduly restricted access to legal counsel.

It remains to be determined whether the new wording amounts to anything different than the old.

I. PROVISION OF DOCUMENTS TO COURT

Under the old Rule 87, a Trustee was required to file a copy of the Assignment, the Preliminary Statement of Affairs, the Statement of Affairs, and the Minutes of the First Meeting of Creditors, with the Bankruptcy Court.

New Rule 87 requires that documents need only be filed if so ordered by the court. There is no longer a requirement to file the Preliminary Statement of Affairs.

J. PROFESSIONAL CONDUCT

Section 14.01 of the BIA, relating to licensing matters, has been amended.

The only substantive amendments appear to be that the section will apply, not only after an investigation ordered by the Superintendent, but also after the Superintendent has made an inquiry. New subsection (g) has been inserted which provides that the Superintendent may require the Trustee to do anything that the Superintendent considers appropriate, and that the Trustee has agreed to.

Section 14.02 has been amended to enhance the requirement of notice to the Trustee.

Under subsection 14.02(1), the Superintendent is to give notice not only of the powers he or she intends to exercise, but the powers which *may* be exercised.

New subsection 14.02(1.1) provides for the Superintendent to issue a summons for the purposes of any testimony required for a hearing.

Section 14.03, which governs conservatory measures, has been amended to permit the Superintendent to take conservatory measures, not only for the protection of the estate, but also for the protection of the rights of the creditors, or a debtor.

The amendments broaden the circumstances in which conservatory measures may be taken, to include circumstances where the Superintendent causes an inquiry to be made.