National Insolvency Review

General Editor: Adam M. Slavens, B.A., LL.B.

VOLUME 32, NUMBER 3 | Cited as (2015), Nat. Insol. Review | JUNE 2015

• CANADIAN CONVERTIBLE DEBENTURES – AVOIDING THE DEATH SPIRAL •

Michael McTaggart, Josh Beaver, Sam Furphy, *Deloitte Restructuring Inc.*
Fady Nakhla, *Deloitte Corporate Finance Inc.*

• In This Issue •

CANADIAN CONVERTIBLE DEBENTURES – AVOIDING THE DEATH SPIRAL

Michael McTaggart, Josh Beaver, Sam Furphy, and Fady Nakhla 25

PERSONAL BANKRUPTCY DISCHARGES: PREPARING FOR AND ARGUING AN OPPOSED DISCHARGE

Calvin J. Ho, Ted Michalos, and Sheldon Title 32

COURT INTERPRETS RECEIVERSHIP ORDER STAY PROVISIONS AND ADDRESSES THE IMPACT OF INTER-CREDITOR DISPUTES ON THE DISTRIBUTION OF PROCEEDS INTO COURT

Joshua Hurwitz and Jaime Auron 38

Over the past decade a wide range of hybrid securities were created enabling growth in non-traditional financing. One form of hybrid security which has been particularly prevalent in Canadian markets is convertible debentures (“convertibles”). Factors such as rising equity markets and investor appetite for higher yield have created opportunities for Canadian companies to leverage convertibles as an effective financing tool.

Convertibles gained popularity amongst investors over the past decade as they provide a source of fixed income through interest, offer a degree of downside protection not found in equity, and offer upside for capital appreciation in rising equity markets.

In 2014, the convertible debenture market in Canada totaled over $14 billion; however, despite the popularity of convertibles, few issuers or investors truly grasp the long-term risks associated with these complex securities.

NATIONAL INSOLVENCY REVIEW

The **National Insolvency Review** is published bi-monthly by LexisNexis Canada Inc., 123 Commerce Valley Drive East, Suite 700, Markham, Ontario L3T 7W8

Design and Compilation © LexisNexis Canada Inc. 2015. Unless otherwise stated, copyright in individual articles rests with the contributors.

All rights reserved. No part of this publication may be reproduced or stored in any material form (including photocopying or storing it in any medium by electronic means and whether or not transiently or incidentally to some other use of this publication) without the written permission of the copyright holder except in accordance with the provisions of the *Copyright Act*.

ISBN: 0-409-91078-3 **ISSN: 0822-2584**
ISBN: 0-433-44393-6 (Print & PDF)
ISBN: 0-433-44694-3 (PDF)

Subscription rates: $465/year (Print or PDF)
$555/year (Print & PDF)

Please address all editorial inquiries to:

Boris Roginsky, Journals Editor
LexisNexis Canada Inc.
Tel. (905) 479-2665; Toll-Free Tel. 1-800-668-6481
Fax (905) 479-2826; Toll-Free Fax 1-800-461-3275
E-mail: nir@lexisnexis.ca.

EDITORIAL BOARD

GENERAL EDITOR

Adam M. Slavens, B.A., LL.B.
Torys LLP

EDITORIAL BOARD MEMBERS

Gerald N. Apostolatos, Langlois Kronström Desjardins S.E.N.C.R.L./LLP, Montréal • **Patrick Shea**, Gowling Lafleur Henderson LLP, Toronto • **Christopher W. Besant**, Baker & McKenzie LLP, Toronto • **Joseph Marin**, Miller Thomson LLP, Toronto • **Hubert Sibre**, Davis LLP, Montréal • **Steven Graff**, Aird & Berlis LLP, Toronto • **David R.M. Jackson**, Taylor McCaffrey LLP, Winnipeg • **Chris D. Simard**, Bennett Jones LLP, Calgary • **Robert P.W. Sloman**, Farris Vaughan, Wills & Murphy, Vancouver • **John R. Sandrelli**, Dentons, Vancouver

Note: This newsletter solicits manuscripts for consideration by the General Editor, who reserves the right to reject any manuscript or to publish it in revised form. The articles included in *National Insolvency Review* reflect the views of the individual authors. This newsletter is not intended to provide legal or other professional advice and readers should not act on the information contained in this report without seeking specific independent advice on the particular matters with which they are concerned.

What Is a Convertible?

A convertible is a hybrid facility composed of two components (debt and equity), each bearing a unique risk and reward profile. The debenture provides for the conversion to equity by the investor, usually at their option. By adding the conversion option the issuer pays a lower interest, or coupon, rate on the debenture as compared to traditional debentures.

Convertibles are priced based on their coupon rate (internal interest rate) and the conversion price (price at which debt is convertible into equity at any time before maturity). Conversion prices are typically set at a 20 to 40 per cent premium to 30 day trailing average stock prices at the time of issuance.

Convertibles present unique advantages and disadvantages for both the issuer and the investor:

Investors gain exposure to an issuing company's credit with an equity risk profile; however, downside risk is limited by separating the security from a full decline in the stock price. On the contrary, investors face subordination to senior secured debt tranches and a loss of the inherent value associated with the convertible feature if the issuing company's share price erodes below the securities conversion price.

Advantages to issuers include the ability to increase financial leverage without the cash burden of traditional secured debt and without pledging assets as security. Despite the benefit of flexibility inherent in the conversion feature of the securities, issuers may face difficulty in restructuring the securities at maturity if share prices at maturity are below the conversion price, and may have to trigger a process leading to a substantial dilution of their existing equity base.

Overview of the Canadian Convertible Debentures Market

The Canadian convertibles market is often viewed as a high-yield market, generally composed of sub-investment grade securities. The majority of Canadian convertible issuances are not formally rated by credit rating agencies.

Canadian mid-cap companies and real estate investment trusts ("REITs") have been particularly active in issuing convertibles over the past decade to finance acquisitions or development projects, enter new markets, or to fund working capital.

In recent years, the issuance of convertibles has slowed significantly. A deterioration of investor interest in these securities presents significant challenges to existing issuers seeking to refinance their maturing convertibles. The issuance of new convertible debentures (in dollars) has decreased by approximately 43 per cent between 2012 and 2014.

The Issue

When the underlying stock price of a company increases above the conversion price, a convertible investor's position is "in the money" because there is an opportunity to convert at the conversion price and sell the equity at the higher market price. As long as the investments leveraging the convertibles issuance are accretive then the underlying stock price will likely increase over time above the conversion price, essentially providing the debenture holder with call option.

A fundamental risk with convertibles is when the underlying stock price decreases materially leading up to maturity. In this situation the issuer is often faced with refinancing challenges. This scenario considerably limits a company's equity-based options.

As an illustrative example, a company issuing a $1,000 convertible debenture with a $20 conversion price anticipates the issuance of 50 shares to convert the debt to equity. If the company's share price is only $5 at the date of maturity, and the company is unable to refinance the debenture, the company must now issue 200 shares, thereby materially diluting its existing equity.

As at February 12, 2015, the Toronto Stock Exchange ("TSX") reported market values on 189 series of convertibles. Of these

- 82 per cent had company share prices trading below the conversion price;
- 37 per cent had company share prices trading below 50 per cent of their conversion price and could be considered "busted"; and
- 12 per cent had a yield to maturity in excess of 20 per cent, an indicator which demonstrates the market believes refinancing may be an issue.

The series trading as "busted" have several striking similarities:

- the majority face maturities in 2017 and 2018;
- many companies have more than one "series" compounding the refinancing issue;
- most companies have embarked on a number of acquisitions or development projects that have thus far failed to be accretive to the underlying stock price;
- most companies have been confronted by restructuring realities such as dividend cuts, cost reduction initiatives, and other refinancing risks that often plague and cause a drag on the trading price; and
- discounted trading prices severely limit equity options for the refinancing of the maturing debentures.

What Are the Risks Relating to Convertible Debentures?

Despite the advantages that convertibles offer issuers, the securities also bring a level of risk. As an issuers' convertibles approach maturity, those companies with share prices trading below the conversion price face common risks:

Refinancing Risk

Companies with near-term maturing convertible debentures often face challenges in refinancing their convertibles as their asset bases are already fully encumbered by senior lenders. Traditional secured lenders typically have the first claim on proceeds from asset sales and additional capital.

Shareholder Dilution and Effective Loss of Ownership Risk

Companies with near-term maturing convertibles often experience downward pressure on their share price as capital markets price the refinancing risks associated with maturity. If a company does not have sufficient liquidity or an ability to refinance their convertibles, they may be forced to convert the securities at current trading prices, thereby causing a significant dilution to their existing shareholders.

Formal Restructuring Risk

Companies who find themselves unable to amend, extend, or refinance their near-term maturing convertibles may be compelled or forced into a formal restructuring arrangement. Maturing convertibles, once classified as current liabilities, may also cause breaches in debt covenants with senior lenders.

What Happens Next?

Through consultation with senior executives from companies with outstanding convertibles, the authors noted that refinancing for maturing convertibles is becoming significantly challenging. In particular, companies whose stock prices are depressed are facing situations in which refinancing is not available. Some companies have successfully utilized international capital markets as a venue to refinance; however, this approach has other unique challenges. Several companies have begun divesting non-core assets to pay out their convertibles; however, many face restrictions on the use of proceeds due to restrictive covenants on senior debt.

Consequently, the Canadian market has a significant quantum of unsecured convertibles outstanding which will require thoughtful strategic maneuvering to refinance. Through our discussions with capital market leaders, it is apparent that credit markets are relatively liquid at this time, making now the ideal time to proactively begin considering strategic refinancing options.

The authors anticipate that a large number of convertible debenture issuers will soon be faced with the need to consider strategic options to refinance their debt. We anticipate that the market will experience an increase in the following activities:

- amend and extend agreements between issuers and investors;
- restructuring proceedings under the *Canada Business Corporation Act* [*CBCA*],[1] ss. 191 or 192 (reorganization arrangements);
- issuance of higher yield debt;
- private and public equity placements; and
- formal restructuring under the *Companies' Creditors Arrangement Act* [*CCAA*],[2] or the *Bankruptcy and Insolvency Act* [*BIA*].[3]

We further anticipate increased activity by distressed debt, special situation, and other sophisticated investors looking to capitalize on market adjustments. Over the past three years there has

been an increased investment by these investors in distressed convertibles as the investors perceive these securities as a value investment in the future equity of the companies.

Not having a refinancing strategy in place can lead to a number of unpredictable and negative effects. To this end, an issuer must take great care to manage its messaging to capital markets. Companies must attempt to communicate that a well-contemplated and executable refinancing exists.

As maturity nears, the options available to convertible issuers become limited. While the authors believe that each and every refinancing strategy will be dependent on the business, the shareholder base, and the state of the capital markets, we believe there are a select number of strategic options available.

What Options Are Available?

There are several strategic options available to issuers of convertibles facing distressed situations:

Convertible Debenture Issuance

Companies may have the ability to replace their existing series of convertibles with a new offering given that there is an existing investor base. The issuance of new convertibles for companies with shares trading below the original conversion price is often expensive. Investors in replacement convertibles typically demand an increase in the coupon rate for the new series as well as a reset of the conversion price to reflect the current equity value of the company.

Equity Issuance

Companies may have the ability to issue private or public equity if capital markets are receptive; however, equity raises carry high fees and result in the dilution of the existing shareholder base. This option is typically available to companies with an existing market capitalization well above the level of convertibles to be retired.

Amend and Extend

An amend and extend is not a refinancing strategy but rather a strategy available to issuers in which they negotiate new coupon, payment, conversion, or maturity terms with their existing investors. In Canada, the majority of convertibles are widely held by retail investors. To execute an amend and extend strategy, an issuer must convince a majority of its investors to vote in favor of the proposed amendments. Investors will typically require the company to offer more lucrative terms such as an increased coupon rate or adjustments to the conversion premium. Further, this strategy often requires concession fees to entice brokers and investors to support the proposal.

Reorganization and Arrangement under the *CBCA*

Section 191 of the *CBCA* refers to a "reorganization" of corporations and is often used in conjunction with *BIA* or *CCAA* proceedings allowing both the debt and equity of a corporation to be restructured. Section 192 of the *CBCA* governs "arrangements" where "it is not practicable for a corporation that is not insolvent to effect a fundamental change in the nature of an arrangement under any other provision" of the *CBCA*.

While s. 192 specifically limits use of this provision to corporations that are "not insolvent", the courts have taken a facilitative approach to the application of s. 192 and the solvency requirement. Recently, there has been an increase in the use of the arrangement provisions of the *CBCA* to restructure companies and groups that are effectively insolvent. In 2012, Yellow

Media, with approximately $200 million in outstanding convertibles, successfully reorganized their capital structure under the *CBCA* following approval from the Superior Court of Quebec.

Where a corporation applies to court for an order under s. 192, the court may make any interim or final order "it thinks fit", thereby affording companies considerable strategic latitude in reorganizing their capital structure. Interim and final orders issued by courts have included provisions for the compromise of debts; share and warrant issues; sale or investor solicitation processes; conversion of debt to equity; and court-ordered stays of proceedings preventing eligible parties from terminating contractual agreements or enforcing rights as creditors.

Advantages of *CBCA* arrangements include the avoidance of formal insolvency proceedings under the *BIA* or *CCAA*, a potentially streamlined restructuring process, and reduced court and stakeholder supervision.

The authors suggest that if consensual arrangements to amend and extend with convertible debenture holders cannot be achieved, the arrangement provisions of the *CBCA* should be considered to propose a compromise to convertible investors. Through the powers of the *CBCA*, issuers can organize and hold meetings of note holders, compel a vote on an arrangement, obtain court approval for an arrangement, and seek a stay of proceedings during the process to prevent creditors from taking action which could irrevocably harm their enterprise value.

Private Equity Sponsor

Companies facing maturing convertibles who do not have a refinancing strategy in place may benefit from seeking a private equity sponsor. A private equity sponsor may provide a standby facility for outstanding convertibles, thereby restoring market confidence that the issuer will be able to meet its convertible obligations at maturity. A standby facility may reduce the dilution effect as downward pressure on a company's share price is relieved. This will provide the issuer with a longer window to implement a permanent refinancing strategy.

Timing plays a critical role in the success of these arrangements. Identifying when to seek out a sponsor is crucial as it will affect the magnitude of standby facility fees. Further, securing a backstop agreement at the right time will alleviate market pricing pressure and the dilutive effect of the equity component of the convertibles. If the balance sheet of the issuer is heavily leveraged with secured debt, these arrangements may result in an additional risk premium upon refinancing.

CCAA

The *CCAA* is a potent restructuring mechanism for insolvent companies and can be effectively leveraged for companies facing significant or complex operating and structural issues. Some triggers which typically preclude a *CCAA* filing include

- missed principal or interest payment;
- insufficient liquidity to satisfy upcoming principal or interest payments;
- approaching debt maturity without a refinancing strategy in place;
- class-action lawsuits and other civil proceedings; and
- general business conditions which render the current operating model unsustainable.

The *CCAA* can be leveraged to facilitate or implement various restructuring measures

including, but not limited to, the sale of surplus or obsolete assets; the disposition of an unprofitable or non-core business segment; the disclaimer of unsustainable contracts or leases; and the compromise of secured and unsecured liabilities. For convertible issuers, the *CCAA* allows companies to negotiate amended payment terms, including principal reductions, extended maturities, coupon reductions, or equity conversions.

The *CCAA* is the most comprehensive restructuring mechanism available to companies with over $5 million in liabilities to respond to cascading events triggered by maturing convertibles. Consequently, the *CCAA* can be expensive; it is a court driven process, requires significant time and energy from management, and requires buy-in from all stakeholders to successfully implement a plan of arrangement.

Notable Transactions

There have been a number of notable restructuring of convertibles over the past several months:

- On November 27, 2014 Discovery Air announced that it has successfully negotiated an amend and extend of approximately $30 million of convertibles.
- On December 19, 2014, Arcan Resources Ltd. announced a plan to convert approximately $171.5 million of convertibles through informal negotiations with bond holders at $0.15 per share resulting in the material dilution of existing shareholders.
- On December 22, 2014, San Gold Corp. filed for creditor protection under the *BIA* citing approximately $59 million of convertibles at filing.
- On December 30, 2014, Ivanhoe Energy received temporary relief from Robert Friedland (private-equity investor) following a default on approximately $73.3 million of convertibles. Ivanhoe Energy entered creditor protection under the *BIA* on February 20, 2015.
- On December 30, 2014, Shoreline Energy announced it would default on convertibles and will seek informal negotiations with bondholders to amend and extend their $18 million of convertibles.
- On January 15, 2015, Gasfrac Energy Services filed for creditor protection under the *CCAA*, citing approximately $40.3 million in convertibles at filing.
- On January 21, 2015, Southern Pacific Resource Corp. filed for creditor protection under the *CCAA*, citing approximately $172.5 million in convertibles at filing.
- On January 23, 2015, Anderson Energy was acquired via an *ABCA* plan of arrangement with approximately $96 million in convertibles.

As demonstrated above, convertibles trading well below par often lead to restructuring events for issuers who face liquidity or refinancing challenges. The unique circumstances of the issuer will often dictate which restructuring strategy is most likely to result in a favorable outcome, and thoughtful analysis must be completed before selecting and executing a chosen strategy.

[*Editor's note:* **Michael McTaggart** is a Senior Manager with Deloitte Restructuring Inc. Michael has worked on restructuring mandates in a wide range of industries including asset-backed commercial paper, commercial real estate, car rentals, manufacturing, printing, steel, publishing, and retail. Michael is a Chartered Accountant, Chartered Business Valuator, and a Chartered Insolvency and Restructuring Professional. Michael received the Jack Biddell Gold Medal in recognition of the highest mark on the 2013 CIRP National Insolvency Exam.

Josh Beaver is a Manager with Deloitte Restructuring Inc. Josh has worked on complex restructuring mandates in a wide range of industries including pulp and paper, forestry, entertainment, and car rentals. Josh is a Chartered Accountant and a Chartered Insolvency and Restructuring Professional.

Sam Furphy is a Manager with Deloitte Restructuring Inc. Sam's focus includes assisting clients with working capital optimization, cost reduction, performance enhancement, and turnaround strategy initiatives in urgent, high-visibility and high-risk transformation environments. Sam is a Chartered Accountant in Australia.

Fady Nakhla is a Vice President with Deloitte Corporate Finance Inc. Fady has worked on many public and private financing and M&A transactions encompassing a wide range of industries. Fady is a Chartered Financial Analyst designation.]

---

1 R.S.C. 1985, c. C-44.
2 R.S.C. 1985, c. C-36.
3 R.S.C. 1985, c. B-3.

• PERSONAL BANKRUPTCY DISCHARGES: PREPARING FOR AND ARGUING AN OPPOSED DISCHARGE •

Calvin J. Ho, *Gowling Lafleur Henderson LLP*
Ted Michalos, *Hoyes, Michalos & Associates Inc.*
Sheldon Title, *MNP Ltd.*

Introduction

A bankruptcy discharge hearing is the forum for the court's determination of a bankrupt's application for discharge which has been opposed by one or more of a creditor, the Trustee, or the Office of the Superintendent of Bankruptcy ("OSB"). This article will aim to provide practical advice on preparing for and arguing an opposed discharge, whether from the perspective of the bankrupt, an opposing creditor, or the Trustee.[1]

Discharge

A discharge from bankruptcy releases the bankrupt from all claims provable in bankruptcy, pursuant to s. 178(2) of the *Bankruptcy and Insolvency Act*,[2] as amended [*BIA*].[3] Claims which are not released by an order of discharge are prescribed by s. 178(1), and include eight classes of debts.[4]

The timelines concerning an automatic discharge of a bankrupt are prescribed by s. 168.1 of the *BIA*. As a result of the *BIA* amendments in September 2009, these are now as follows:

i) 9 months for a first-time bankrupt with no surplus income obligations;

ii) 21 months for a first time bankrupt with surplus income obligations;

iii) 24 months for a second time bankrupt who does not owe surplus income obligations; and

iv) 36 months for a second time bankrupt with surplus income obligations.[5]

Oppositions to the automatic discharge of a bankrupt are prescribed by s. 168.2(1) of the *BIA*, which requires a creditor, the Trustee, or the OSB to provide notice of such opposition in the prescribed form and manner prior to the automatic discharge date. Once a creditor, the

Trustee, or the OSB opposes the automatic discharge of a bankrupt, the Trustee is required to apply for an appointment for the discharge hearing.[6]

Other procedural requirements imposed upon the Trustee include

i) giving five days' notice to the bankrupt that the Trustee intends to apply for an appointment for the discharge hearing;

ii) preparation of an application to court to fix a date for the discharge hearing; and

iii) once the date is fixed by the court, the Trustee is required to send out a notice, not less than 15 days prior to the scheduled hearing date, to the OSB, the bankrupt, and every proven creditor.[7]

The Trustee is further required to prepare a Report of Trustee on the Bankrupt's Application for Discharge pursuant to s. 170(1) of the *BIA*, which must be filed at least two days prior to the discharge hearing, with a copy forwarded to the OSB, the bankrupt, and every creditor who has requested a copy at least 10 days prior to the scheduled hearing date. It is ordinary practice for the Trustee to send its s. 170(1) Report to any opposing creditors. The Trustee's s. 170(1) Report indicates, *inter alia*, the Trustee's recommendation concerning the bankrupt's discharge.[8]

The OSB may also file a Report, as may be deemed expedient or necessary for the hearing.[9] In respect of bankruptcy discharges, the OSB's primary mandate concerns debtor compliance with the *BIA*, and with the integrity of the Canadian bankruptcy regime. The OSB may not necessarily oppose a bankrupt's discharge, but may direct or indicate its expectations of the Trustee to oppose a bankrupt's discharge. This typically occurs following findings made on examination of the bankrupt by the Official Receiver,[10] which are reported upon and contained in a Report prepared by the OSB.

Forum

For most regions in Ontario, a discharge hearing is usually conducted before a Registrar in Bankruptcy of the Bankruptcy Court, under a Registrar's jurisdiction pursuant to s. 192(1) of the *BIA*. In other jurisdictions in Ontario, a discharge hearing may be held before a Judge of the Superior Court of Justice.[11] A Registrar may refer any matter within its jurisdiction, including a discharge hearing, to a judge, which occurs in the rare case.

Power of the Court

Pursuant to s. 172 of the *BIA*, the court may

i) grant or refuse an absolute order of discharge;

ii) suspend a bankrupt's discharge; or

iii) grant an order of discharge subject to terms or conditions (make a conditional order of discharge).

If any facts referred to in s. 173 of the *BIA* are proven, the court may include in any conditional order, payment terms, or such other terms as the court may direct. If there are no s. 173 facts proven, the court may nonetheless impose a conditional order that includes terms concerning a bankrupt's earnings, or income, or after-acquired property.[12]

Suspending the bankrupt's discharge and making a conditional order may happen concurrently.

In certain circumstances the court may refuse a discharge. A refusal may be ordered with or without conditions required prior to a bankrupt being able to seek leave to re-apply for a discharge.

In the case of high personal income tax debtors (over $200,000 of personal income tax debt, which represents over 75 per cent of the bankrupt's total unsecured proven claims), a discharge hearing must be held after any of the ordinarily prescribed periods for an automatic discharge prescribed by s. 172.1 of the *BIA* (*i.e.*, after nine months; 21 months; 24 months; or 36 months, as discussed above).[13] "Personal" income tax debt does not include GST or an income tax debt that arose from an assessment for directors' liability.

The court may also adjourn a scheduled discharge hearing, whether prior to commencement or after commencement of a hearing and direct the parties accordingly in respect of further disclosure, or obtaining an interpreter and similar procedural items. In the Toronto Bankruptcy Court, if a discharge hearing is anticipated to be longer than 30 minutes, the court will ordinarily adjourn the hearing to a special long matter date, which is co-ordinated through the Bankruptcy Court office.

Preparation for a Discharge Hearing

From a Trustee's Perspective

The Trustee is an officer of the court and represents the body of creditors as a whole. Aside from its statutory duties prior to the discharge hearing date, the Trustee will ordinarily have its file available at the discharge hearing and often assists the court with factual information obtained during its administration. The majority of Trustee oppositions are the result of an omission or failure by the bankrupt to adequately perform his/her duties as set out in s. 158 of the *BIA*, including the obligation to attend mandatory counselling. If the Trustee is satisfied that the bankrupt has subsequently complied with his/her duties, and if there are no further substantial grounds for opposition, then the Trustee will ordinarily withdraw its opposition prior to or at the discharge hearing. The Trustee may also have opposed the bankrupt's discharge in connection with "property" issues as they relate to the bankrupt's duties, given the Trustee's mandate to realize upon all property of the bankrupt. While the discharge of a bankrupt and realization upon property of the bankrupt are not mutually exclusive, the Trustee will ordinarily aim to resolve all property issues prior to the discharge hearing if possible.

The Trustee may also share the same concerns and grounds for opposition as an opposing creditor and a creditor's opposition itself may provide the Trustee with new information and areas for review concerning the bankrupt. The Trustee also seeks to assist the bankrupt generally, by providing information to the bankrupt as to procedure and the potential advisability of retaining counsel. It is important to recognize, however, that the Trustee does not legally represent the bankrupt and the Trustee cannot advocate for the bankrupt or prepare the bankrupt for a discharge hearing. Nonetheless, the Trustee often acts as a conduit between the bankrupt and an opposing creditor and/or the OSB, to promote a settlement or resolution of the issues. The Trustee may also retain its own counsel in respect of a discharge hearing.

From an Opposing Creditor's Perspective

Critical information is gleaned from (i) the Bankrupt's sworn Statement of Affairs; (ii) the Trustee's Report; (iii) any s. 161, *BIA* examination conducted by the Official Receiver; (iv) any s. 163(1), *BIA* examination conducted by the Trustee; and (v) any s. 163(2), *BIA* examination conducted by the creditor.

Written questions may also be posed to the bankrupt prior to the discharge hearing which the bankrupt is obliged to answer in accordance with the bankrupt's duties under the *BIA*.

The opposing creditor will seek to establish s. 173, *BIA* facts and other grounds for opposing the bankrupt's discharge, as set out in the opposing creditor's notice of opposition. The notice of opposition should be sufficiently clear as to the grounds for opposition and should not contain frivolous or unfounded allegations (for example, alleging s. 173(1)(*k*) should generally be avoided where there has been no criminal conviction or prior judgment of fraud or fraudulent breach of trust).[14]

Organization of documents and evidence relied upon is important in conducting an efficient cross-examination and presenting an opposing creditor's position. A document brief is often useful to both counsel and the court.

It is important to ascertain whether an appropriate notice of opposition has been filed in a timely manner. If another creditor or the Trustee or Superintendent has already filed an opposition to discharge, and a hearing date is obtained, a notice of opposition may be filed by any other creditor, so long as it is prior to the discharge hearing date.[15] Notwithstanding, the court may question optics and propriety if a creditor suddenly opposes at the eleventh hour.

There is a danger in "sheltering" behind the Trustee's or another creditor's opposition, given for example, the Trustee may withdraw its opposition prior to the hearing date, or at the hearing. Alternatively, the grounds set forth in another creditor's opposition may be materially different.

A creditor should also assess costs versus benefits in proceeding with an opposed hearing versus seeking a resolution or even a withdrawal of opposition.[16] Although a creditor may seek costs if any conditional order for payment is made by the court,[17] actual recovery is dependent upon what proceeds are actually paid under any conditional order, together with what dividends may be received based on the value of a creditor's claim in the estate.

From the Bankrupt's Perspective

A bankrupt's goal is obviously an absolute discharge from bankruptcy, or alternatively a conditional discharge on as favorable terms as possible. Most bankrupts are self-represented at their discharge hearing, and at times may be unaware that they may require representation.

If representing a bankrupt, counsel should seek to obtain clarity in respect of any notice of opposition. Prior to the discharge hearing, particulars may be requested concerning grounds for opposition raised by an opposing creditor, the Trustee, or the OSB. Counsel should also review whether there are any inaccuracies in respect of any report,[18] or in respect of the bankrupt's Statement of Affairs or any other document which the bankrupt has signed or provided to the Trustee, which should either be corrected or addressed.[19]

Counsel will also wish to obtain copies of any documentary or affidavit evidence to be relied upon by an opposing creditor or the Trustee, and may also wish to know the identity of any witnesses.

Counsel should also ascertain if there are any unfulfilled duties by a bankrupt (*e.g.*, providing outstanding income tax information), or outstanding surplus income payments required. Addressing and resolving these with the Trustee prior to the scheduled discharge hearing is highly desirable and may result in a resolution (*e.g.*,

a consent conditional order for payment of outstanding surplus income), or alternatively in narrowing the issues. Resolution of unfulfilled duties prior to the discharge hearing will also present your client in a more favorable light if there are other issues concerning s. 173 of the *BIA*.

As with any trial, potential resolution prior to the hearing with the Trustee, an opposing creditor (and the OSB if applicable) should be weighed against the risk of a contested discharge hearing.

If an interpreter is required, a Ministry of the Attorney General certified interpreter (or equivalent) may be mandatory, as is the case in Toronto.[20] It is best to seek a certified interpreter at an early date, given there may be difficulties in retaining one for certain languages.

If the bankrupt does not attend his/her discharge hearing, then the court may grant a "No Order", that permits the Trustee to seek its own discharge, following which the rights of creditors will be revived if the bankrupt remains undischarged.[21] In these instances, the bankrupt may later seek the re-appointment of a Trustee and/or to make a fresh application for a discharge, although this will no doubt remain subject to un-fulfilled duties or outstanding issues.[22]

The Superintendent of Bankruptcy's representative may be in attendance in circumstances where the OSB has opposed the discharge, or alternatively where the OSB has directed the Trustee to oppose the discharge. As discussed above, pursuant to s. 170(3) of the *BIA*, theSuperintendent is also at liberty to make a report to court, and if in attendance, the OSB's position is informed by policy concerning "debtor compliance" and the overall integrity of the bankruptcy system.

Conducting the Hearing, Evidence, and Evidentiary Burden

The discharge hearing is a trial and all rules of evidence applicable to civil trials and the *Rules of Civil Procedure* apply where the *BIA* or *Bankruptcy and Insolvency General Rules*[23] do not specifically apply.

The court will consider the Trustee's Report;[24] any OSB Report; notices of opposition from creditors; affidavit and other documentary material; evidence from any examination under s. 163(1) or (2), *BIA*;[25] and *viva voce* evidence called at the hearing. For discharge hearings there is no requirement for documentary or evidentiary disclosure prior to the hearing as under the *Rules of Civil Procedure*. In practice it is generally not required to admit the authenticity of documents, although it is desirable for opposing counsel to exchange documents and agree upon a common brief and/or undisputed facts.[26] There is no benefit to ambushing any party and the court will often grant an adjournment if the evidentiary record is not agreed upon or is incomplete.

The evidentiary burden is upon the bankrupt to satisfy the court that an order of discharge should be granted.

Because the discharge hearing operates as the bankrupt's application for discharge, it is common procedure for the bankrupt first to give *viva voce* evidence before the court. The bankrupt is provided opportunity to describe the circumstances leading to his/her bankruptcy and factors to be considered by the court concerning the bankrupt's application for discharge. Opportunity is then given to an opposing creditor, the Trustee, and the OSB (if in attendance) to cross-examine the bankrupt. The bankrupt may also

present witnesses who are also subject to cross-examination by opposing parties.

An opposing party may ask questions of the bankrupt concerning the bankrupt's Statement of Affairs and other bankruptcy estate documentation, and may submit affidavit evidence and also introduce witnesses to give *viva voce* evidence.[27] Witnesses produced by an opposing party may be cross-examined by the bankrupt. Expert evidence may also be introduced in accordance with the *Rules of Civil Procedure*.

The presiding judicial officer (whether a Registrar or Judge) may, and typically will, ask questions during the discharge hearing and will receive submissions as to disposition and outcome following the completion of testimony and cross-examinations.

Appeal

An appeal from an Order of a Registrar in Bankruptcy lies to a Judge of the Superior Court of Justice pursuant to s. 192(4) of the *BIA*.[28] An appeal of a Registrar's order or conditional order made on a bankruptcy discharge hearing is not a trial *de novo*.[29]

A Registrar's or Judge's determination on a discharge hearing is an exercise of judicial discretion. An appeal court may modify or moderate conditions imposed on a discharge hearing. However, the standard for appeal is whether there was any omission of the consideration, or the misconstruing of some fact, or violation of some principle of law.[30]

Conclusion

Aside from understanding the procedural intricacies associated with a bankruptcy discharge hearing, it is important and often beneficial to consider the perspectives of each of the participants, whether it be the bankrupt, the Trustee, or an opposing creditor, together with what end may be achieved by proceeding with an opposed hearing. As with any trial, preparation and understanding are key elements to success or resolution concerning a bankrupt's discharge hearing.

[*Editor's note*: **Calvin J. Ho**, M.A., LL.B., is a bankruptcy and insolvency lawyer practising with Gowling Lafleur Henderson LLP in Toronto.

Ted Michalos, CPA Trustee, is President of Hoyes, Michalos & Associates Inc.

Sheldon Title, CPA, CA, CIRP, is Senior Vice-President of MNP Ltd.]

---

1 This article is modified from a paper presented to the Ontario Bar Association Institute 2014 – Critical Developments in Insolvency and Bankruptcy Law – February 7, 2014, and aims to complement a prior, very practical paper by one of the joint authors – *Discharge Applications – The Ins and Outs*, OBA Institute Conference – Current Topics in Bankruptcy and Insolvency, February 9, 2012, by Brandon Jaffe and Sheldon Title.

2 R.S.C. 1985, c. B-3.

3 *BIA*, s. 178(2); "claims provable" are prescribed by s. 121, *BIA*.

4 *BIA*, s. 178(1).

5 *BIA*, s. 168.1; "surplus income" is defined in s. 68(2) as "the portion of a bankrupt individual's total income that exceeds that which is necessary to enable the bankrupt individual to maintain a reasonable standard of living, having regard to the applicable standards established under subsection (1)"; also reference OSB Directive 11R2-2013.

6 *BIA*, s. 168.2.

7 *BIA*, ss. 168.2(2), 169(6).

8 *BIA*, s. 170(1), (2). It is not uncommon for Trustees to file Supplementary Reports based on events which have occurred since the filing of the initial s. 170 *BIA* Report.

9 *BIA*, s. 170(3).

10 Conducted under s. 161, *BIA*.

11 *BIA*, s. 192(2).

12 *BIA*, s. 172(1), (2).

13 *BIA*, s. 172.1.

14 Section 173(1)(*k*) expressly provides that the bankrupt has been "guilty" of any fraud or fraudulent breach of trust. Such a finding is difficult to adequately determine on an application for discharge, and therefore

may be reserved to a different forum; see *Re: Kemper,* [1961] O.J. No. 380, [1961] 2 C.B.R. (N.S.) 130 (H.C.J.). However, in other cases, courts have held that the court should decide whether the bankrupt has been guilty of fraud or fraudulent breach of trust, particularly where the evidence is clear and unequivocal; see *Re Herdman*, [1992] A.J. No. 118, 10 C.B.R. (3d) 33 (Q.B.). An opposing creditor should also consider whether independent proceedings under s. 178 of the *BIA*, which survive bankruptcy, are a preferable alternate route.

15 *BIA*, s. 170(7).

16 Jaffe and Title, *Discharge Applications, The Ins and Outs*, *supra.*, note 1, at para. 5.

17 *BIA*, s. 197(6.1).

18 Under *BIA*, s. 170(6), the bankrupt may contest the statements made in the Trustee's Report by giving notice.

19 Jaffe and Title, *Discharge Applications, The Ins and Outs*, *supra.*, note 1, at para. 4.

20 It is ordinarily incumbent upon the bankrupt to obtain an interpreter, given it is the bankrupt's application for discharge.

21 See for example, *Re Ross*, [2003] O.J. No. 6042, 50 C.B.R. (4th) 274 (S.C.J.).

22 If a discharge is refused and there are no provisions or a fixed future date for re-applying for a discharge, it would appear that a variation of the order would be required under s. 187(5) of the *BIA*. See *Re Cadesky*, [1940] O.J. No. 110, 22 C.B.R. 61 (H.C.J.); *Re Clarke*, [2000] A.J. No. 266, 3 C.B.R. (5th) 294 (Q.B.).

23 C.R.C. c. 368 [*BIA Rules*].

24 The Trustee's Report is considered *prima facie* evidence and must be accepted unless contradicted by other evidence; although the court is not bound by the Trustee's report, it is given considerable weight; see *Re Barrick*, [1980] B.C.J. No. 1050, 36 C.B.R. (N.S.) 286 (C.A.); *Re Simpson*, [1984] B.C.J. No. 1264, 50 C.B.R. (N.S.) 109 (S.C.).

25 *BIA*, s. 163(3).

26 Jaffe and Title, *Discharge Applications, The Ins and Outs*, *supra*. note 1, at para. 6.

27 *BIA*, s. 170(4) – an opposing creditor may attend in person or be represented by counsel. However, if the opposing creditor is a corporation, it will be subject to the *Rules of Civil Procedure* requiring representation by counsel.

28 *BIA*, s. 192(4); Rule 30, *BIA Rules*.

29 *Re Saban*, [2012] O.J. No. 5844, 2012 ONSC 7009 (Comm. List).

30 *Ind. Acceptance Corp. Ltd. v. Lalonde*, [1952] S.C.J. No. 15, 32 C.B.R. 191, [1952] 2. S.C.R. 109 (S.C.C.); but see also *Re Gregoris*, [1985] O.J. No. 76, 55.C.B.R. (N.S.) 282 (C.A.).

• COURT INTERPRETS RECEIVERSHIP ORDER STAY PROVISIONS AND ADDRESSES THE IMPACT OF INTER-CREDITOR DISPUTES ON THE DISTRIBUTION OF PROCEEDS INTO COURT •

Joshua Hurwitz and Jaime Auron
Osler, Hoskin & Harcourt LLP

In *8527504 Canada Inc. v. Liquibrands Inc.* [*Liquibrands*],[1] the Ontario Superior Court of Justice (the "court") provided guidance on the interpretation of the stay provisions in a receivership order. The court also addressed the request from a second ranking creditor to have proceeds from assets paid into court rather than being paid to the first ranking creditor, pending resolution of a claim by the second ranking creditor against the first.

Background

Liquibrands Inc. ("Liquibrands") was a secured creditor and sole shareholder of Sun Pac Foods Ltd. ("Sun Pac"), a manufacturer of branded beverage products, among other things. Liquibrands ranked second in priority with respect to Sun Pac, behind 8527504 Canada Inc. ("852 Canada Inc."), a related company to Bridging Canada Inc. ("Bridging"). Bridging provides alternative solutions to borrowers who are not able to otherwise secure traditional financing.

In October 2012, Bridging advanced a multi-facility loan to Sun Pac – Facility A was a $5 million revolving loan and Facility B was a term loan on equipment – that was secured on the assets of Sun Pac. Bridging subsequently assigned these loan interests to 852 Canada Inc. Liquibrands guaranteed $1 million of Facility A (the "Guarantee"), supported by security over all its assets.

Although Sun Pac was nearing a production deal with Loblaws, the company was short on working capital and was in default of its obligations to 852 Canada Inc. by August 2013. In September 2013, 852 Canada Inc., Sun Pac, and Liquibrands entered into a Forbearance and Amending Agreement (the "Agreement") to provide Sun Pac with a bridge loan in anticipation of the Loblaws contract coming to fruition. This bridge loan involved two tranches of funding, including a demand non-revolving loan under a Facility D.

852 Canada Inc. agreed to hold off on enforcing its rights absent an Event of Default, but did not advance the $1.15 million Facility D loan at any point. Sun Pac became insolvent and shut down operations, leading 852 Canada Inc. to commence a receivership application under which BDO Canada Ltd. ("BDO") was appointed as receiver of Sun Pac. Meanwhile, Liquibrands and Sun Pac commenced an action against 852 Canada Inc. and Bridging, seeking $100 million of damages for breach of the Agreement, for the alleged lost profits that would have been earned pursuant to the Loblaws deal.

BDO realized proceeds from Sun Pac's assets (the "Sun Pac Proceeds") and proposed an interim distribution of $383,381 from the Sun Pac Proceeds to 852 Canada Inc.

Decision and Analysis

Interpretation of the Stay Provisions in a Receivership Order

Sun Pac and Liquibrands argued that the stay provisions in the receivership order stayed Liquibrands' and Sun Pac's action against 852 Canada Inc. and Bridging (the right to commence the action then being held by the receiver). Newbould J. held that paras. 7 and 3(j) of the model receivership order used on the Ontario Superior Court of Justice (Commercial List) (the "Commercial List") enable a receiver to continue an action previously commenced by a debtor without the necessity of obtaining leave. Read together, these sections stipulate that no proceedings against a debtor shall be commenced without leave (or the consent of the receiver); however, this does not preclude a receiver from initiating a proceeding without seeking leave.

Request from the Second Ranking Creditor to Have Proceeds Paid into Court

Justice Newbould proceeded to consider the request made by Liquibrands that the Sun Pac Proceeds be paid into court by the receiver, pending a decision in the action brought by Sun Pac and Liquibrands against 852 Canada Inc. and Bridging. Liquibrands cited Rule 45.02 as support for its position. Rule 45.02 grants the power to the court to order funds be paid into court where a party's right to a specific fund is in question. Newbould J. held that the Rule was not applicable to the current situation, as the plaintiff had no direct proprietary claim to the specific funds in question.

Justice Newbould clarified that the Sun Pac Proceeds held by the receiver were not subject to any claim by Liquibrands that could achieve a

priority ranking over 852 Canada Inc. He emphasized that even if a real issue existed in respect of Sun Pac's and Liquibrands' damages claim against 852 Canada Inc. and Bridging, it was not an issue that would impact the decision in front of the court.

In response to Liquibrands' contention that no receiver should be appointed until its lawsuit against 852 Canada Inc. and Bridging had been resolved, Newbould J. held that the terms under which Liquibrands gave its Guarantee were in no way limited by the possibility of success in a separate action. He also highlighted a Subordination, Assignment, Postponement and Standstill Agreement made at the same time as the Guarantee, under which Liquibrands agreed not to do anything that might delay, defeat, impair, or diminish the priority rights of 852 Canada Inc. In addition to reinforcing Newbould J.'s reasons with respect to the Sun Pac Proceeds, this assurance by Liquibrands was the final straw in Newbould J.'s decision to find it just and convenient for a receiver of Liquibrands to be appointed.

Conclusion

The *Liquibrands* decision emphasizes that the stay provisions in the Commercial List model receivership order do not require a receiver to seek leave to continue an action previously commenced by a debtor company. Furthermore, *Liquibrands* illustrates that funds from proceeds will only be withheld from a rightful creditor where a serious question exists as to that creditor's rights to those proceeds. The funds will not be re-routed and paid into court on the mere possibility that the first-ranking creditor may owe some unrelated moneys to a subordinated creditor.

Further, it demonstrates a reluctance by the court to act definitively with respect to issues between creditors that may or may not directly impact the proceedings at hand. Such matters will instead be left for resolution by the interested parties.

[*Editor's note*: **Joshua Hurwitz** is an Associate in the Insolvency & Restructuring Group at Osler, Hoskin & Harcourt LLP. His practice is focused on complex corporate restructurings, reorganizations and recapitalizations, as well as insolvency, bankruptcy and enforcement of debtor and creditor rights.

Jaime Auron is a Student-at-Law at Osler, Hoskin & Harcourt LLP.]

---

[1] [2014] O.J. No. 5821, 2014 ONSC 7015 (Comm. List).