LAPOINTE ROSENSTEIN
MARCHAND MELANÇON
L.L.P. Attorneys

The Debt Restructuring Proposal: An Alternative to Bankruptcy?

M^tre Harry H. Dikranian

M^tre Alexa Rahal

Mathilde Delorme
Articling student

March and April 2020 have seen and will continue to see many companies facing serious challenges. Amongst others, the COVID-19 pandemic as declared by the World Health Organization, government decrees declaring a state of health emergency in Quebec, the forced closure of a large number of businesses, the compulsory isolation for many Quebecers returning from travel, and social or physical distancing recommended for all.

It is very likely that the coming weeks will put increasing pressure on many entrepreneurs who, eventually, may even go so far as to consider **bankruptcy** as an ultimate solution.

A debt restructuring proposal ("Proposal") could however be a solution to give a second chance to those hoping to save their businesses. The purpose of this article is to lay out some of the rules applicable to Proposals as well as the advantages of considering such a procedure.

What is a Proposal?

The Proposal, provided for in the *Bankruptcy and Insolvency Act*[1] ("**BIA**"), **allows an insolvent person** (the "**Debtor")** **to propose a formal agreement to its creditors to reduce the amount of money owed or to extend repayment terms in order for the Debtor to continue its operations**. It is equally possible to combine debt reduction and extended repayment terms as a solution to benefit all parties; the creditors and the Debtor. It should be noted that the reimbursement of certain debts must be integrally included in the Proposal.[2] In summary, the Proposal could serve as a means for the Debtor to be released from a portion of its debts.

The Proposal, unlike the consumer proposal,[3] allows for the filing of a notice of intention to file a Proposal ("**Notice of Intention**"). Following the filing of a Notice of Intention, within five days, the authorized trustee forwards the notice of intention to the creditors affected by the Proposal.[4]

If the Debtor filing the notice of intention is a **commercial tenant**, it may terminate its lease by giving a thirty day notice. The landlord may, however, object. If applicable, the court must grant the termination of the lease if it is satisfied that the Proposal cannot be viable without such termination.[5] In these circumstances, the landlord will not have the right to claim rents due in advance, but may make a claim for the losses it has suffered and, in doing so, it may become a creditor under the Proposal. [6]

Also, the Debtor who files a Notice of Intention has a period of thirty days during which payments to creditors, foreclosures and legal proceedings are no longer possible against it.[7]

This period may be extended by the court, but never for more than forty-five days at a time and for a maximum of five months in total, without counting the initial period of thirty days.[8] Thus, the Debtor can benefit, if necessary, from **six consecutive months to finalize its Proposal**.

The **advantage of the Notice of Intention** is therefore to take the necessary time to provide a Proposal that is both attractive enough to justify its acceptance by the creditors and that can be complied with by the Debtor.

Once the terms of the Proposal are agreed upon, whether or not it has been preceded by a Notice of Intention, the Proposal must be filed for registration with the official receiver of the Office of the Superintendent of Bankruptcy.[9] From the time of its filing, a meeting of creditors must be convened within twenty-one days for the creditors to position themselves in favour or against the Proposal.[10]

In order for a Proposal to be accepted, a vote in favour of acceptance of the Proposal from a numerical majority of creditors and for which the claims are at least two thirds of the value of the total sums owed, must be obtained.[11]

It is also essential to note that **in the event that the Proposal is rejected** by the creditors, the Debtor is deemed to have made an assignment,[12] or in other words, is deemed to have declared bankruptcy.

In the event of acceptance by the creditors, the approval of the court must then be obtained. The court may refuse the Proposal if it considers that the conditions of the Proposal are neither reasonable nor to the benefit of the creditors.[13] Just as in the event of a refusal by the creditors, if the court does not approve the Proposal, the Debtor is deemed to have made an assignment in bankruptcy.[14]

Once the Debtor's Proposal has been accepted by the creditors and approved by the court, the Debtor must comply with the conditions contained therein, failing which the Debtor will be deemed to have made an assignment in bankruptcy.

It is therefore always **essential**, when drafting the Proposal, to find a way to **meet the needs and demands of creditors**, all the while ensuring that the Debtor will be able to comply with its **financial commitments**.

Once the Proposal has been completely and properly executed by the Debtor, the Debtor receives a **certificate of compliance**.[15] Once the certificate is issued, the Debtor is released from its debts included in the Proposal.[16]

What debts can be included in a Proposal?

Not all debts can be repaid by means of a Proposal. In fact, under a Proposal, the Debtor cannot be released from debts owed to secured creditors, except in certain circumstances, nor from certain other debts considered non-dischargeable for social policy reasons.[17] Consequently, these types of debts cannot be included in the Proposal.

Specifically, what debts are not released by a Proposal?

Non-dischargeable debts include **secured debts** such as those guaranteed by **hypothecs**, **mortgages** and any other such charges.[18] Although in theory these debts are not included in the Proposal, it is possible, even desirable; to reach an agreement with secured creditors. A secured creditor can agree to be included in the Proposal and, in such a case, would be entitled to vote on the Proposal.[19]

As previously mentioned, such **non-dischargeable debts** cannot otherwise be included in the Proposal, but the Debtor will not be discharged from such debts even in the event of bankruptcy. The debts that are qualified as not being released by a certificate of compliance (or non-dischargeable) include those relating to **alimony or support obligations** for a spouse or children; debts resulting from **fraud**; debts resulting from a **student loan** granted by the government if the person filing the Proposal ceased their studies over seven years prior to the filing of the Proposal, and; other types of debts as provided under the BIA.[20]

Criteria relating to extending the time to file a Proposal: Overview of case law

If the Debtor files a Notice of Intention, it must prepare the Proposal within a certain time period. Section 50.4 (9) of the BIA provides that the initial thirty day limit to prepare the Proposal may be extended and the Quebec Court of Appeal has clarified the criteria to be considered in order to grant such an extension.

For the court to grant extensions, it must analyze the following criteria:

> "**a)** the insolvent person acted - and continues to act - in good faith and with due diligence;
>
> **b)** it would likely be able to make a viable proposal if the requested extension was granted;
>
> **c)** the extension requested will not cause serious harm to the creditors".[21]

The Court of Appeal clarified that the court must also consider, if applicable, the efforts made by the Debtor and the overall progress of the case.[22] According to the Court of Appeal, the primary objective of the BIA, which is to favour Proposals rather than bankruptcies, must also be taken into account.[23]

Several judgments in other Canadian jurisdictions have also reiterated the importance of promoting Proposals rather than the winding-up of a business. This is particularly the case in the decision of Cantrail Coach Lines Ltd.[24] of the Supreme Court of British Columbia. It held that "the intent of the Act and these specific sections is rehabilitation and that matters considered under these sections are to be judged on a rehabilitation basis rather than on a liquidation basis."[25]

The New Brunswick Court of Appeal has similarly specified that, as long as the criteria of the BIA are satisfied, it is justifiable to extend delays in order to give Debtors sufficient time to prepare their Proposal.[26] The trial judge had refused to grant an extension of delays, and such decision was thereafter overturned by the New Brunswick Court of Appeal.

Criteria for the approval of a Proposal by the court: Overview of case law

Section 59 (2) of the BIA provides that the court must **refuse to approve a submitted Proposal if it does not contain reasonable conditions, does not benefit all creditors or if the Debtor has committed infractions** outlined in sections 198 to 200 of the BIA. The court's power is therefore said to be discretionary.[27]

The question of what are **"reasonable terms"** for the purposes of this section has arisen on several occasions. The Quebec Superior Court established a non-exclusive list of criteria to be considered in deciding the reasonableness of the conditions of a Proposal.[28] It should first be noted that these criteria must always be considered while bearing in mind three differing interests: those of the Debtor, of the creditors and of the general public.[29]

The **detailed criteria**, cited with approval on at least three occasions by the Quebec Court of Appeal,[30] are:

1) The Debtor has the **burden to prove** that it is justified in submitting the Proposal;

2) The court hearing a request for approval must **weigh the consequences** of an approval and a refusal;

3) In exercising its discretion and for the purposes of its analysis, the court must be satisfied that, if it approves the Proposal, the creditors will gain **certain advantages over a bankruptcy**;

4) The **behaviour of the Debtor** is a factor to be taken into consideration; if there is any indication of collusion or otherwise, the matter will be further investigated;

5) In assessing the reasonableness of a Proposal and weighing the interests at stake, the court will have to consider the **level of recovery for unsecured creditors**; when the amounts offered to unsecured creditors are minimal and the payment represents a small fraction of what is owed to them, this should be taken into account in the final analysis;

6) Similarly, when the circumstances seem to indicate that **an investigation under the BIA** would help to clarify otherwise obscure matters, this will influence the court in the exercise of its discretion.[31]

Furthermore, the **good faith of the Debtor is important**. In fact, to the extent that the court finds that the legislative requirements are met and that the Debtor is in good faith, it will approve the Proposal.[32] For instance, if there are irregularities or the appearance of maneuvers that would harm creditors, these would be factors justifying the court's dismissal of the Proposal.[33]

To decide whether or not to approve the Proposal, the court will study the trustee's report and will hear the trustee, the Debtor, any opposing or dissenting creditors as well as any other testimony it may require.[34]

Conclusion

The Proposal has various advantages over bankruptcy. First, it allows the Debtor who files a Notice of Intention to **have enough time to draft a Proposal** with which it will be able to comply and which will be sufficiently interesting to creditors and for the court to accept. Second, it allows the Debtor to obtain **more favourable payment terms**. In addition, during the period between the filing of the Notice of Intention and that of the filing of the Proposal, **the Debtor avoids any seizure of its property** as well as any recourses against it by its creditors.

Ultimately, to the extent that the Debtor files its Proposal within the prescribed delays and it is accepted by the creditors and the court, the Debtor will be released from a significant portion of its debts. **The Proposal therefore prevents an insolvent company from going bankrupt**, which is a very important advantage. Nevertheless, the Proposal must be judiciously managed, otherwise the Debtor is at risk of finding itself filing for bankrupt anyway.

In these difficult times, due to the COVID-19 crisis, it is our view that the deadlines provided for in the BIA may exceptionally be extended. Note to the federal legislator and to our courts: it could be essential to extend deadlines in order to allow entrepreneurs to recover from the crisis! In fact, in the coming months, it will be essential to support our local and national businesses, to stimulate the economy and avoid further job losses.

In addition to the subject of this article, there is also a similar procedure under the *Companies' Creditors Arrangement Act* ("**CCAA**"). This law allows insolvent businesses owing more than $5 million in debt to restructure and avoid bankruptcy. The CCAA provides greater flexibility and gives the court significant discretion to deal with the various complex issues that may arise through the restructuring process. The CCAA and its restructuring measures will be discussed in our next article.

This article was written iin collaboration with M^tres^ André Rousseau, Michel Ménard, Mélissa Rivest and Nicholas Backman.

For more information, contact one of the team members:

Harry H. Dikranian
514 925-6382
harry.dikranian@lrmm.com

Alexa Rahal
514 925-6360
alexa.rahal@lrmm.com

André Rousseau
514 925-6389
andre.rousseau@lrmm.com

Michel Ménard
514 925-6328
michel.menard@lrmm.com

Mélissa Rivest
514 925-6387
melissa.rivest@lrmm.com

Mathilde Delorme, stagiaire
514 925-6338
mathilde.delorme@lrmm.com

[1] *Bankruptcy and Insolvency Act*, S.C. 1985, c. B-3, art. 50 and following.
[2] Art. 60 BIA. Principally sums owing to the State, for example, the *Income Tax Act* or the *Employment Insurance Act*, etc., unless the relevant public authorities agree.
[3] Art. 66.11 and following BIA.
[4] Art. 50.4(6) BIA.
[5] Art. 65.2(1) to (3) BIA.
[6] Art. 65.4(4) to (6) BIA.
[7] Art. 69(1) BIA.
[8] Art. 50.4(9) BIA.
[9] Art. 62(1) BIA.
[10] Art. 51(1) and 54(1) BIA.
[11] Art. 54(2) (d) BIA.
[12] Art. 57 BIA.
[13] Art. 58 and 59(2) BIA.
[14] Art. 61(2) BIA.
[15] Art. 65.3 BIA.
[16] Office of the Superintendent of Bankruptcy, *Definitions*, online :<https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br01467.html>.
[17] Art. 178(1) BIA.
[18] Art. 2 BIA, under definition “Secured creditor”.
[19] Art. 50.2 and 50.3 BIA.
[20] Art. 178(1) BIA. There are fines, awards in civil cases, dividends.
[21] Art. 50.4(9) BIA.
[22] Raymor Aerospace Inc. vs. Béliveau, 2009 QCCA 678, par. 39 “In this case, the trial judge should have allowed the companies to demonstrate their efforts since February 13 and their progress. Considering himself bound by the conditions imposed the previous week, the written proof of satisfaction having not been made, the judge refused any extension, without giving the companies the opportunity to try to explain their progress. Therefore, the criteria for an extension of delays mentioned in para. 9 of section 50.4 BIA were not considered, contrary to the BIA's objective of favouring proposals over assignments.” (*Our translation and emphasis*)
[23] *Ibid.* See the following cases as well: Produits Forestiers Tibo inc. (In the matter of the proposal of), 2007 QCCS 1607, par. 57; Gauthier (Notice of Intention of), 2013 QCCS 4084.

[24] In the Matter of the proposal of Cantrail Coach Lines Ltd., 2005 BCSC 351.
[25] *Ibid.*, par. 11.
[26] Doaktown Lumber Ltd. vs. BNY Financial Corp. Canada, 1996 CanLII 4791 (NB CA), par. 12 à 14. Excerpt cited by the Quebec Court of Appeal in Raymor Aerospace Inc. vs. Béliveau, see note 19, par. 41.
[27] Technique Acoustique (LR) Inc. (In the matter of the propoal of), 2014 QCCA 525, par. 77.
[28] Magi (Trustee of), 2006 QCCS 5129, par. 18 and 19.
[29] *Ibid.*, par. 18.
[30] Chan (In the matter of the proposal of), 2007 QCCA 727 ; Dupré (In the matter of the proposal of) vs. Tur, 2012 QCCA 830 ; Technique Acoustique, see note 27.
[31] Magi (Truste of), see note 28, par. 19.
[32] Jacques Deslauriers, ***La faillite et l'insolvabilité au Québec***, 2e éd., Montréal, Wilson & Lafleur, 2011, par. 492.
[33] *Ibid.*
[34] Art. 59(1) BIA.